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ABSTRACT

The loan collection efforts of the Department of Education are discussed in hearings held as part of fact finding prior to reauthorization of the Higher Education Act. Attention is directed to the collection record of the Department, the rationale for shifting collections from federal to private collectors, and the reasons why two of the remaining three federal collection offices are to be closed. The activity of the Department's Office of Inspector General in the area of student loan defaults and collections is summarized. The amount outstanding in the National Direct Student Loan program is over a billion dollars. The Guaranteed Student Loan program has about a $1,300,000 default; about $2 billion totally in default payments have been made to guarantee agencies by the government. The Department is shifting loan collection functions that exist in three regional offices--San Francisco, Chicago, and Atlanta, into the San Francisco office. Under the Debt Collection Act, the Department is allowed to report defaulted student borrowers to credit bureaus. Under provisions of the Department Collection Act, the Department has used computer matching to identify federal employees who are in default in student loans. (SW)

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LOAN COLLECTIONS

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HEARING

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

OF THE

COMMITTEE ON EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, D.C., ON AUGUST 4, 1983

Printed for the use of the Committee on Education and Labor

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LOAN COLLECTIONS

THURSDAY, AUGUST 4, 1983

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON POSTSECONDARY EDUCATION,
COMMITTEE ON EDUCATION AND LABOR,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in room 2261, Rayburn House Office Building, Hon. Paul Simon (chairman of the subcommittee) presiding.

Members present: Representatives Simon, Harrison, Penny, Packard, and Gunderson.

Staff present: Maryln McAdam, majority counsel; and Betsy Brand, minority legislative associate.

Mr. SIMON. I am advised by minority staff we can go ahead.

The subcommittee will convene today to conduct a hearing on the collection efforts of the Department of Education. The subcommittee first held hearings on this subject in May 1981, when the Department announced that it was going to transfer its collection efforts to private collection agencies instead of using Federal collectors. At that time the subcommittee expressed its serious concerns that private agencies would not be able to match the record set by the Federal collectors and that the result might be that the collection of defaulted student loans would decrease.

We have now learned that the Department intends to take the transfer of collections to private agencies one step further and intends to close the Chicago and Atlanta offices that deal with collections and assign greater numbers of accounts to the private collectors. In so doing, 106 Atlanta employees will lose their jobs as will 107 Chicago employees.

These collectors have done an admirable job. In Atlanta, they return approximately $1.5 million each month, from what I have seen. Employees of the Chicago office have collected over $20 million in the last 2 years. I have done some rough calculating on their salaries. Their total salaries in the Atlanta office is about $470,000 for the year.

A recent report by the General Accounting Office casts further doubts about the wisdom of such a move. The Department of Education was the only agency of six investigated that was not meeting its own collection targets. According to that same report the Department was also the only agency whose collections for fiscal year 1982 were actually lower than for fiscal year 1981. Department officials say that part of the reason was the replacement of 700 Federal collectors in 1981 by private agencies.

I am not opposed to the use of private collection agencies, but this should be done only if, in fact, they are at least equal to Federal collectors. At present there is some confusion in documenting that this is the case. The Federal collectors say the private people are getting the cream of the collections, and I hear that it is the other way around when I talk to the private agencies.

The purpose of the hearing today is to learn from the Department of Education what their collection record really is, and to review the rationale for shifting collections from Federal to private collectors and for closing two of the remaining three Federal collection offices. The information the subcommittee has been able to gather prior to the hearing is inconsistent and conflicting. It is our hope that this hearing can resolve those conflicts.

We would like to welcome our witnesses today and begin our hearing with a representative of the General Accounting Office, Mr. John Simonette, Associate Director of the Financial Management Division.

STATEMENT OF JOHN F. SIMONETTE, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, ACCOMPANIED BY ERIC MARTS, WASHINGTON REGIONAL OFFICE; JEFFREY STEINHOFF, JERRY WILBURN, AND CHRIS CHRISMAN, HEADQUARTERS STAFF

Mr. SIMONETTE. Thank you, Mr. Chairman. We are pleased to be here today to discuss debt collection at the Department of Education.

Before proceeding, I would like to introduce my colleagues. On my far right, Eric Marts, from our Washington regional office; Jeffrey Steinhoff and Jerry Wilburn from the headquarters staff. We also have Chris Chrisman from our headquarters staff doing some work for your staff in the area of collection efforts.

I do have a prepared statement. With your permission, I would like to summarize the highlights of that statement.

Mr. SIMON. Your full statement will be entered in the record.

Mr. SIMONETTE. Thank you.

Debts owed the Government are enormous and growing each year, with billions of dollars delinquent. Federal agencies reported that, at the start of fiscal 1982, receivables due from U.S. citizens and organizations exceeded $180 billion, over $33 billion of which was delinquent. By the end of fiscal 1982, these amounts had further increased to approximately $200 billion and $38 billion, respectively, with nontax delinquencies totaling about $14 billion.

To stem the continued growth in these numbers, the Congress and GAO have long called for strengthened debt collection. We have reported that the Government was not doing an effective job of accounting for and collecting its debts. Recognizing the need for improved financial management, the administration made debt collection a management priority. At the request of the House Committee on the Budget, we recently reviewed the administration's effort to strength debt collection during fiscal 1982 and the prospects for future collections.

The Department of Education was one of the six agencies included in our review. During fiscal 1982, Education acted to resolve

longstanding debt collection problems and in doing so, increased its oversight of schools administering student loans. Education developed a comprehensive debt collection improvement plan which assisted in organizing the agency's debt collection efforts.

In addition, the agency created a credit management board which Education officials believe has enhanced communication between program and administrative personnel regarding credit management issues. Debt servicing and collection issues addressed by the Department included improving the accuracy of information systems for the guaranteed student loan and national direct student loan programs; improving the control and reporting of financial transactions; and agumenting Education's collection staff with private sector collectors and temporary employees.

I know the subcommittee is interested in Education's use of private collection agencies. Because our review for the Budget Committee focused on Education's overall approach to strengthening debt collection, we did not analyze in depth or evaluate the private collectors' performance or the contracting of these services.

However, in a separate study your subcommittee recently requested, we are evaluating Education's use of private collection agencies versus in-house staff. This review, which will focus mainly on the performance of the two private collectors currently under contract to Education, is in the preliminary stage. While we do not at this time have any information on the adequacy of the private collectors' performance, we have several observations.

The Debt Collection Act of 1982 gives Federal agencies the authority to contract with private collection agencies. Previously, Education, beginning in 1979, entered into two pilot contracts for collection services. In 1981, the Department entered into two more contracts for collection services, an action which followed the decision to reduce its in-house collection staff.

Our 1981 report, "Stronger Actions Needed to Recover $730 Million in Defaulted National Direct Student Loans," recognized Education's decision to use private collection agencies was consistent with statutory and regulatory provisions. We noted, however, that the cost effectiveness of using contract collectors had not been fully determined and recommended that Education monitor the performance of these contractors to insure cost effectiveness. The Government did not have any past experience using private collectors and Education is the only agency to date that has entered into large-scale collection contracts.

Education is presently monitoring the current contracts. Under these, the Department transferred to the contractors about $635 million of defaulted loans. Education expects the contractors over a 3-year period to collect at least 10 percent of the amount assigned, or $63.5 million. The Department reported that through May 30, 1983, almost $24 million, or about 4 percent, has been collected.

Monthly collections have increased. Only $4 million was collected during the first 6 months of the contracts, while in the following 12 months, collections totaled almost $20 million. Education projects that contractor collections, which totaled $8 million in fiscal 1982, will be about $20 million in fiscal 1983. It points to the acceleration of collections as evidence that the contractors will be more successful in future periods.

One last observation about the use of contract collectors: OMB claims that the contractor performance is hampered by current regulations which do not allow contractors to directly bring suit against debtors. Instead, accounts must be referred to Justice for litigation. Contractors contend that this greatly affects their collection efforts because litigation is one of the most important tools available to private collection agencies.

Another important issue facing Education is how to resolve its longstanding accounting and reporting problems. In fiscal year 1982, the Department was not able to submit to Treasury and OMB a reliable financial report on debt collection activities. One Education official estimated a 25-percent error rate in reported collections, and OMB debt collection officials expressed concern over the quality of Education's data.

Education is planning many short-term reporting improvements but officials believe that the key to solving their accounting and reporting problems is a long-term effort to install an information system capable of handling all the Department's loan programs. The Department has assessed the information needs of each program and is presently evaluating various alternative systems.

While Education expects a new system to be installed during the 1986–87 academic year, we caution that the agency has had past problems in developing and operating an automated information system for the guaranteed student loan program.

Although acting to improve its debt collection program, Education's fiscal 1982 reported collections were about $6 million less than in fiscal 1981 and the agency fell far short of its OMB target. Total collections as reported to OMB by Education declined by 1 percent during the year to $653 million from $659 million in fiscal 1981. Of the six agencies we reviewed, this was the only instance of an agency reporting declining total collections. At the same time, Education reported that its total receivables grew by over 5 percent.

OMB's formula for measuring collection performance considers both total collections and receivables. The decrease in Education's total collections, when factored by the correponding increase in receivables, computers out to a $41 million relative drop in collections. In terms of the $225 million target for increasing collections given to Education by OMB, the agency, therefore, fell short of the goal by $266 million.

Department of Education officials explained the shortfall by pointing to the reduction of 700 in-house collector positions during fiscal 1982. They believe that the private contract collectors will eventually fill this void, but the contractors will need more time to reach maximum productivity. Even at maximum productivity, however, the contractors would not have been able to make up the $266 million shortfall reported for fiscal 1982.

As I mentioned earlier, contract collections total $8 million in fiscal 1982, or a little over 1 percent of total reported collections for the year, with Department of Education's goal for the contractors being $63.5 million for a 3-year period.

Officials also said that because of reporting delays, the results of their fiscal 1982 initiatives were not reflected in collection totals for the year.

One final matter, Department of Education should be well served by the Department Collection Act, which was passed this past fiscal year. For example, full implementation of the act's provision allowing the offset of Federal employees' salaries to satisfy general debts owned to the Federal Government should increase future collections. Using computer matching, in fiscal 1982, the agency identified about 47,000 Federal employees who were in default on $68 million in student loans.

Another provision requiring individuals who apply for Federal loans or assistance to furnish their social security numbers should make NDSL defaulters easier to find. Finally, Department of Education's plans to refer about 500,000 delinquent borrowers to credit bureaus this year should also help spur future collections.

This concludes my statement. I will be happy to answer any questions you or the other members may have.

[Prepared statement of John F. Simonette follows:]

PREPARED STATEMENT OF JOHN F. SIMONETTE, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear before you to discuss debt collection at the Department of Education.

Debts owed the Government are enormous and growing each year, with billions of dollars delinquent. Federal agencies reported that, at the start of fiscal 1982, receivables due from U.S. citizens and organizations exceed $180 billion, over $33 billion of which was delinquent. By the end of fiscal 1982, these amounts had further increased to approximately $200 billion and $38 billion, respectively, with nontax delinquencies totaling about $14 billion.

To stem the continued growth in these numbers, the Congress and GAO have long called for strengthened debt collection. We have reported that the Government was not doing an effective job of accounting for and collecting its debts. Recognizing the need for improved financial management, the Administration made debt collection a management priority. At the request of the House Committee on the Budget, we recently reviewed the Administration's effort to strengthen debt collection during fiscal 1982 and the prospect for future collections. We focused on the six Federal agencies having the highest nontax delinquencies and concluded that the Administration, through the Office of Management and Budget (OMB), has implemented a program for improving debt collection; actually collected more debt than was anticipated by OMB; and ensured tht in the near future debt collection prospects look good.

The Department of Education was one of the six agencies included in our recent review. During fiscal 1982, Education acted to resolve long-standing debt collection problems and in doing so increased its oversight of school administering student loans. Education developed a comprehensive debt collection improvement plan which assisted in organizing the agency's debt collection efforts. In addition, the agency created a credit management board which Education officials believe has enhanced communication between program and administrative personnel regarding credit management issues. Debt servicing and collection issues addressed by the Department included: improving the accuracy of information systems for the Guaranteed Student Loan and National Direct Student Loan (NDSL) program; improving the control and reporting of financial transactions; and augmenting Education's collection staff with private sector collectors and temporary employees.

I know the Subcommittee is interested in Education's use of private collection agencies. Because our review for the Budget Committee focused on Education's overall approach to strengthening debt collection, we did not analyze in depth or evaluate the private collectors' performance or the contracting for these services. However, in a separate study your Subcommittee recently requested, we are evaluating Education's use of private collection agencies versus in-house staff. This review, which will focus mainly on the performance of the two private collectors currently under contract to Education, is in the preliminary stage. While we do not at this time have any information on the adequacy of the private collectors' performance, we have several observations.

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The Debt Collection Act of 1982 gives Federal agencies the authority to contract with private collection agencies. Previously, Education, beginning in 1979, entered into two pilot contracts for collection services. In 1981, the Department entered into two more contracts for collection services, an action which followed the decision to reduce its in-house collection staff.

Our 1981 report "Stronger Actions Needed to Recover $730 Million in Defaulted National Direct Student Loans" (HRD-81-124, September 30, 1981) recognized that Education's decision to use private collection agencies was consistent with statutory and regulatory provisions. We noted, however, that the cost effectiveness of using contract collectors had not been fully determined and recommended that Education monitor the performance of its contractors to ensure cost effectiveness. The Government did not have any past experience using private collectors and Education is the only agency to date that has entered into large scale collection contracts.

Education is presently monitoring the current contracts. Under these, the Department transferred to the contractors about $635 million of defaulted loans. Education expects the contractors over a 3-year period to collect at least 10 percent of the amount assigned, or $63.5 million. The Department reported that through May 30, 1983, (18 months into the contract) almost $24 million, or about 4 percent, has been collected.

Monthly collections have increased. Only $4 million was collected during the first 6 months of the contracts, while in the following 12 months, collections totaled almost $20 million. Education projects that contractor collections, which totaled $8 million in fiscal 1982, will be about $20 million in fiscal 1983. It points to the acceleration of collections as evidence that the contractors will be more successful in future periods.

One last observation about the use of contract collectors: OMB claims that contractor performance is hampered by current regulations which do not allow contractors to directly bring suit against debtors. Instead, accounts must be referred to Justice for litigation. Contractors contend that this greatly affects their collection efforts because litigation is one of the most important tools available to private collection agencies.

Another important issue facing Education is how to resolve its longstanding accounting and reporting problems. In fiscal 1982, the Department was not able to submit to Treasury and OBM a reliable financial report on debt collection activities. One Education official estimated a 25 percent error rate in reported collections, and OMB debt collection officials expressed concern over the quality of Education's data.

In an attempt to establish reliable accounts receivable information, Education has converted old computer records on receivables originated in the former Office of Education, to a new format suitable for its present accounting system. The agency is also in the process of reconciling computerized records to manual records to resolve discrepancies and ensure that accounting records are accurate.

Education is planning many short-term reporting improvements but officials believe that the key to solving their accounting and reporting problems is a long-term project involving the conversion of their accounting and loan systems. The Department's chief financial officer has established a committee to oversee the Department's loan program. The Department has assessed the information needs of each program and is presently evaluating various alternative systems. While Education expects a new system to be installed during the 1986-1987 academic year, we caution that the agency has had past problems in developing and operating an automated information system for the Guaranteed Student Loan Program.

Although acting to improve its debt collection program, Education's fiscal 1982 reported collections were about $6 million less than in fiscal 1981 and the agency fell far short of its OMB target. Total collections as reported to OMB by Education declined by 1 percent during the year to $653 million from $659 million in fiscal 1981. Of the six agencies we reviewed, this was the only instance of an agency reporting declining total collections. At the same time, Education reported that its total receivables grew by over 5 percent.

OMB's formula for measuring collection performance considers both total collections and receivables. The decrease in Education's total collections, when factored by the corresponding increase in receivables, computes out to a $41 million relative drop in collections. In terms of the $225 million target for increasing collections given to Education by OMB, the agency, therefore, fell short of the goal by $266 million.

Education officials explained the shortfall by pointing to the reduction of 700 in-house collector positions during fiscal 1982. They believe that the private contract collectors will eventually fill this void, but the contractors will need more time to reach maximum productivity. Even at maximum productivity, however, the contrac-

tors would not have been able to make up the $266 million shortfall reported for fiscal 1982. As I mentioned earlier, contract collections totaled $8 million in fiscal 1982, or a little over 1 percent of total reported collections for the year, with Education's goal for the contractors being $63.5 million for a 3 year period.

Officials also said that because of reporting delays the results of their fiscal 1982 initiatives were not reflected in collection totals for the year. Further, they pointed out that loan origination fees totaling about $150 million in fiscal 1982 were not counted in computing their collection shortfall. The analysis OMB gave us for fiscal 1982 did not include these amounts as collections against Education's target. The fees do not represent the collection of delinquent debt. Also, we were told the fees were not included in reported collections for fiscal 1981.

One final matter, Education should be well served by the Debt Collection Act. For example, full implementation of the act's provision allowing the offset of Federal employees' salaries to satify general debts owed to the Federal Government should increase future collections. Using computer matching, in fiscal 1982, the agency identified about 47,000 Federal employees who were in default on $88 million in student loans. Another provision requiring individuals who apply for Federal loans or assistance to furnish their social security numbers should make NDSL defaulters easier to find. Finally, Education's plans to refer about 500,000 deliquent borrowers to credit bureaus this year should also help spur future collections. This concludes my statement. I will be happy to answer any questions you or the other members may have.

Mr. SIMON. Thank you very much.

As I listened to and read your statement, I gather you are not ready to make the bottom-line determination yet—or do you have any feel for it—on whether it is more effective dollarwise for the Federal Government to go through private collectors, or have our present system, or whether we ought to have a mix of the two?

Mr. SIMONETTE. We have not had an opportunity to evaluate that in any depth, so I would have to defer on any overall positions on that at this point.

A couple of things I would mention to the subcommittee, however, it is important that the cost-effectiveness determination be made by any agency in deciding whether and to what extent to use outside help—in this case, private collection firms. Also, I would stress that even in our own regulations—and GAO has long called for the use of private collection agencies as one of the tools, as one of the private sector tools to help collect the Government's debts—but that this is intended to be a supplement to the agency's overall collection program.

So, as I say, we don't have any information at this time to precisely state whether it is more cost effective to use these outside firms and to what extent. So that is the best I think that we can provide you at this time.

Mr. SIMON. I am not going to try to put words in your mouth, but it seems to me you are leaning in the direction that makes sense to me—that is, that the Federal Government collect what it can—in a sense do the easy ones—and then when you get to the really tough cases, turn them over to the private collection agencies.

Mr. SIMONETTE. That makes sense to us. I think that is a businesslike approach to this matter. I would also mention that—I guess I can't stress this enough—it is important to have adequate financial reporting systems to help support that process because if the agency does not have a good reading on the portfolio of its debts, what the age of it is, what debts are heading toward delinquency status, as opposed to those that are recently collectable, the agency is really at a great disadvantage to try to make the determination as to what should go outside, versus what their people

should be trying to collect. So I can't stress enough the importance of good financial systems to support that process.

Mr. SIMON. And which brings up another question. I dropped in at the Chicago office, where they were working on collections, and one of the points the employees made was that our equipment isn't adequate to really follow these cases. We are not doing the kind of job that we really ought to do. You are not getting your money's worth out of us because we don't have the right kind of equipment.

Do you have anything to offer on that?

Mr. SIMONETTE. We are well aware that Department of Education, as well as several of the major agencies in the Government, have had problems in the area of financial systems, including the adequacies or inadequacies of their equipment to support those systems, and we haven't examined in the Department of Education the equipment problems or even its overall financial systems process, but we are well aware there are major problems there. And this is one of the key problems, key factors that throughout the Government, as we have looked at the debt-collection area over the past several years, that has fallen far short. The systems and the supporting equipment for those systems is badly out of date and has been neglected over the years, and without that, the collection programs just suffer tremendously.

Mr. SIMON. I have a full committee meeting also. We may have to recess just briefly. I am going to turn this over to one of my colleagues to chair. Does it make sense at all—I confess to being a little provincial, coming from the State of Illinois—to close an Atlanta office and a Chicago office and have all the collections done from one end of the country? From San Francisco, you have to make collections from Maine and Georgia and Florida as well as the Midwest——

Mr. SIMONETTE. Mr. Chairman, we have no information, we have not had an opportunity to examine into that particular question. One of the things we would certainly want to do right at the outset would be to obtain the Department rationale for that move, what was their basis for that action, then try to make some judgments based upon that.

Certainly it is important that the people be in the right geographic locations to collect the debt. We can't say that closing or consolidating offices into one or two offices is bad, per se, but it would be important that the people be at the right places to attempt to collect the money, to follow up on the delinquency, and to try to take action in a timely manner.

In connection with the timeliness, again that is one of the things that we have seen in the debt-collection efforts over the past years, that the longer debts become delinquent, the older it gets, the more difficult it becomes to collect that. I think that stands to reason.

Mr. SIMON. I am going to ask one of my colleagues, Frank, you have seniority, about 30 days before Tim, on this subcommittee—I am not sure. I will ask my colleague to take over.

I would also like to submit some questions in writing, if you can respond to those for the record.

Mr. SIMONETTE. Be happy to.

Mr. HARRISON [now presiding]. Good morning. I think we ought to ask Mr. Penny if he has any questions at this time.

Mr. PENNY. I am curious to know about the 700 employee reduction in the Department of Education. Is that the result of the closing of the 2 offices, or were there further reductions elsewhere in the department that helped bring that total to 700?

Mr. SIMONETTE. I would like to ask one of my colleagues to help respond to that.

Mr. MARTS. Our understanding is that was the result of a mandate earlier that the Department of Education reduce its staff in order to accommodate the legislation that set up the Department. I think it was an internal decision that they reduce the staff at this particular position—the internal collectors, that those collectors were term employees, temporary employees—they originally had no expectation for full-time, long-term employment.

Mr. PENNY. Those individuals that were involved in collection on loans were hired with an understanding that it would not necessarily be long-term employment?

Mr. MARTS. They are called term employees, meaning hired for a specific term of time to accomplish a specific job. Our understanding is that they often were not full-time employees. When they were terminated, in the correspondance that we have seen from these employees, various contracts, they admit themselves: "No, we never expected long-term employment," but this seems to come as a little of a surprise.

Mr. PENNY. What was the justification for laying off the 700 employees? Was it directly related to the authority to contract out?

Mr. STEINHOFF. Basically, they were required to reduce their personnel strength by, I believe, 500-some positions and this was the means by which they chose to do that. These were term employees and, therefore, they would not have to go through a RIF procedure.

Mr. PENNY. Under the requirements to cut back total personnel in the Department, this Department chose to accomplish most of those reductions in one fell swoop, in one particular division of the Department?

Mr. STEINHOFF. Yes.

Mr. PENNY. I identified here that you are now conducting a study of the effectiveness of the private collection agency process, but in your study of the Department's efforts to collect, did you identify strengths or weaknesses in their collection capability and, if so, can you outline some of those for me and maybe indicate what impact a 700-employee reduction in that area might have on the capability of the Department to meet its objectives?

Mr. STEINHOFF. First, this is an area where these problems have built over many years. During fiscal year 1982, we found that they made strides in many areas to try to get a long-term, viable program on line, and in my view, one of the key things is improving collections at the schools in that the bulk of the money is collected at the schools.

When we talk about the in-house collection staff, when we talk about the private collection groups that are now involved, we are talking about $50, or $60, or $70 million a year, which is roughly one-tenth of the total collections. Most of the money is collected out of the schools. They did work with the schools during the year. They have provided default rate goals.

I believe it is very key that you have some incentive to collect and by saying to a school, if your default rate exceeds a certain rate, you will get no new funds, or if it is between a certain range, your funds will be reduced for the year, those type of things I think will result down the road in a better overall debt collection process.

There were several other things they did during the year. They have, as John mentioned before, the line on 47,000 Federal employees who owe $68 million and they already have started to collect against those debts. They go to the IRS and they have better and more current mailing addresses. So there are many, many things they have done.

We found that they had a very comprehensive plan, which in our view, addressed most of the long-term problems that they have, but these things will take time to resolve. It will take time for the schools to be doing the job they should be doing. It will take time to do many of the things that the Debt Collection Act of 1982 allows them to do.

Mr. PENNY. I do have some other questions I would like to ask. I am told though we are needed for a quorum downstairs and we are also needed on the floor for a vote, and so I will hold any additional questions until later.

Mr. HARRISON. I just have one question. I will probably pursue this with one of the later witnesses. Do you have any idea what percentage of the student loans that go into default are eventually discharged as a result of a bankruptcy proceeding?

Mr. SIMON. The next witness is no stranger to this room, Ed Elmendorf, Assistant Secretary for Postsecondary Education. If he is here?

He is here, I see him back there. Pleased to have you with us.

STATEMENT OF EDWARD ELMENDORF, ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION, DEPARTMENT OF EDUCATION, ACCOMPANIED BY RICHARD HASTINGS, DIRECTOR OF MANAGEMENT SERVICES, OFFICE OF STUDENT FINANCIAL AID

Mr. ELMENDORF. Good morning, Mr. Chairman.

Mr. SIMON. You may proceed as you wish, reading your statement or putting it in the record.

Mr. ELMENDORF. I wouldn't dare read it.

Mr. SIMON. OK. I do ask that you put it in the record.

Mr. ELMENDORF. I will try to summarize the main points in about 10 minutes.

Mr. SIMON. Great.

Mr. ELMENDORF. I would like to introduce, on my left, Mr. Richard Hasting, who is the Director of Management Services for the Office of Student Financial Aid. He also is the student loan collection expert within the Department of Education. I will give him all the hard questions and I will take all the easy ones.

We appreciate being here this morning. I understand the topic we need to talk about is loan collection activities. Having heard some of the prior testimony, I do now agree that they have some misinformation which should be corrected for the record and we will do that this morning.

It is commonly known that there is a major problem in the Federal Government—the Government is owed a great deal of money, as an institution. Looking from the field into the Federal Government, my major concern was only with the national direct student loan. However, working from the inside out and having the responsibilities for student loan collections, gives me a much different perspective, one that I would like to share with you this morning.

There are, I believe, some causes for the poor record of collection in the past. I think one of the major ones is the years of inattention and neglect that have developed over time.

The second is almost as serious, it is a kind of persuasive attitude that the Government's role is to be generous in lending money but to be rather lenient in trying to collect its debts.

The President has decided he wants to change that and in 1981 he acted to direct all the Federal agencies to improve their information management, their financial management, their fund disbursement and their debt management systems. In fact, under OMB Bulletin 9311, a requirement as imposed on all Federal agencies that they upgrade their credit management and debt collection practices, and within the Department of Education, we have established a credit management task force and credit management board which is doing just that.

Before we get specifically into the questions which you asked we be prepared to discuss, I would like to talk about some accomplishments in the area of loan collections within the Department of Education. In the past year, the department has implemented a number of very major initiatives, some of which have been discussed by GAO, some of which will be discussed I believe by Mr. Thomas, but they emanate directly from action by the Congress in the Debt Collection Act of 1982.

We have enhanced our own performance, contrary to the prior testimony, in the area of the Office of Student Financial Loan and Student Loan Collections and one important thing that should be recognized is that the Debt Collection Act of 1982 gave Federal agencies, for the first time, the same tools to use in collection which the private sector has had for years. That, I think makes a major difference in our ability to collect and it is a major difference I think in terms of performance that we would show you as part of our testimony.

Three of the major initiatives I would like to address this morning deal with the referral ability of delinquent borrowers to the credit bureaus. That has already been mentioned once; the salary offset activities against Federal employees in default on student loans; and the full implementation of the private sector collection contracts.

On the first—major initiatives—this is one I believe in time will be shown to be probably one of the most persuasive tools in loan collection, and that is the referring of delinquent borrowers to credit bureaus.

As I mentioned before, until the Debt Collection Act of 1982 we did not have that authority. We have negotiated agreements with major credit bureaus for nationwide coverage with respect to the federally insured student loans and national direct student loan defaults assigned to the Department.

We have established procedures and systems necessary for credit bureau reporting, and expect that we will be referring about 500,000 defaulted NDSL accounts this year alone.

The second major effort, I am sure you may have heard about, deals with measures of salary offset provided again under the Debt Collection Act of 1982 against Federal employees in default on their student loans.

We conducted a computer match which identified about 46,800 employees in default on over 50,000 loans, with an amount outstanding of approximately $67.7 million.

As of May 2, the Department has received payments in December of $2.3 million on over 7,248 accounts 1,341 of those accounts had been paid in full. We have in repayments over $6 million already and we haven't yet effected the salary offset procedures and won't probably until late September when the regulation has had a chance to clear through the timing procedures provided for under the law.

The second, in addition, has sent packages of procedures and practices to about 63 agencies or department heads outlining for them the efforts underway to collect from Federal employees who are in default, meeting the schedule of August 17 for all Federal employees to come and pick up the list of all default employees within their department. There will be an extraordinary effort by individual agencies to directly collect from the employees. If unsuccessful, they will refer those employees to us for salary offset.

The third activity deals with the private sector collection contracts. I note a major number of your questions deal with that. We have fully implemented now two major private sector contract collection agency provisions. The contractors got their first paper in January 1982, so we have got about a year and a half experiences with the private sector. We have options up to 3 years under those contracts.

Since that time, we have transferred about 400,000 accounts to the 2 contractors valued at $641 million. Overall, we expect we could contract for over $1 billion $100 million in paper that is in default.

These improvements have contributed to increases in collections. In fiscal year 1981—this is to correct the record—there has been a 50-percent improvement each year in collections since 1981, despite the reduction in employees, and in fiscal year 1981, we collected $46 million in defaulted student loans. In fiscal year 1982, $55.5 million. In fiscal year 1983, we are already at $70 million, and we will probably collect in excess of that number.

In spite of these accomplishments, we think more can be done and we are going to be recommending some legislative proposals to the Congress for approval. One of those proposals is to modify the procedures for disbursing funds under the FISL program. We would like under that program, to have essentially the same authority that now exists for the State guarantee agencies, and that is for a collection to be made payable both to the student and to the institution as copayees. That would allow I think some assurances for the potential for overpayment to be reduced, for the risk of no-show defaults to be reduced, and essentially, for us to catch

the funds before they get out the door and come into a default claim situation and collection situation.

Second, we will probably be asking Congress to allow for a greater exchange of information on student defaulters with credit bureaus to be shared with the State guarantee agencies. Under current law that is not allowed. We would like to have that changed so we can open up that process. Far more in this case is better and the Inspector General, I believe, will testify that we need more of the upfront kind of systems checks. This would be one of those system checks that might prevent dollars from coming into default in the first place.

The third legislative proposal will be to try to broaden the student eligibility requirements to provide that a student may not receive any financial aid if that student still owes a refund on a grant or overpayment situation, or any other situation, or is in default on a loan made under title 4 at any institution. Right now, under current law, if a student borrows under the guaranteed student loan at one institution, goes into default under that institution, leaves the State and goes to another State, they may, because of the lack of collection and balance in the system, be able to start the process all over again. We would like to conclude that.

Fourth, we believe that the 6-year Federal statute of limitations for filing suits for collection of loans should apply to the guarantee agencies as well as to the Federal Government. It does not do that now. If there were allowed, the 6-year limit would apply to the guarantee agencies, or if the State limit is longer than 6 years, this longer limit would apply.

There is another legislative proposal—it has been mentioned once—that is, the Department of Justice has recently submitted legislation to contract with private attorneys for litigation of Federal debts, including student loan accounts. That authority does not now exist. All of those accounts must be litigated directly by the Department of Justice. We believe that the threat of prompt litigation in these cases by private attorneys in cases where it is warranted, would have a positive effect on collections.

The other points I would like to make—because you did mention the credit management program, and it is a major project within the Department of Education—we have learned that in terms of delivery of student financial assistance for students enrolled in postsecondary that it is very complex and time consuming project. It is complex, we think, because of the byproduct of the student aid programs which has been tremendous, the complexity of the statutes and the diversity of these institution participants.

Even the financial aid community has questioned the approach to the current delivery systems and asked whether there isn't a better way to deliver the same dollars. We agree. Internal evaluation and GAO reports both have questioned the effectiveness and efficiency of the current delivery system.

The Secretary directed the Comptroller of the Department of Education to form a credit management program, to review the current delivery systems, to evaluate modifications and develop alternatives to the system. What the Secretary essentially wants is an effective management information system, an auditable financing management system, and an efficient and effective debt man-

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agement system to reduce administrative costs for all parties, including students and institutions, and better communications among all participants.

In doing that we contracted with two outside professional contractors. We have done this in conjunction with a top level credit management board within the Department, composed of the Assistant Secretary and above level. Westinghouse Corp. was charged with the responsibility to identify an alternative system that could be used to get the Federal student aid dollars to eligibile recipients in correct amounts and in a timely way. Advanced Technology, Inc. is developing an analytical model which could be used to evaluate the various delivery systems. The total cost for both contracts is $673,000.

In addition, the department has held public hearings in four major cities to solicit comments from the public regarding improvements in the process.

Now, to get to your specific questions. Private collectors was one area of concern. We received the first assigned loans for collection in January 1982. Currently, the private agencies are responsible for about 400,000 accounts valued at approximately $641 million. As of May 31 of this year, the private agencies had collected slightly more than $21 million. As of June, it is $23.3 million.

We should keep in mind—I believe this is contrary to one of the statements, Mr. Chairman, that you made—that all of the contracts that he had, the schools themselves, the lenders, and other private collection agencies contracted for by institutions, were unable and unsuccessful in attempting to collect. In other words, it is what would under normal circumstances in a corporation or business be considered clearly for writeoff. We feel there is potential recovery. That is one of the reasons why private contractors have been used and we are proposing legislation that private attorneys be used to try to get those dollars back into the Treasury before they have to be considered a receivable that has been written off.

The Federal and private collection effort together in 1 month, the month of March of this year, produced $7.4 million. That exceeds by a million and a half the best month that we have ever had in the history of the loan completion program. We paid out to the private collector contractors about $7 million in commissions. That represents about 30 percent of the $23.3 million that we have collected. In other words, we are paying out about $1 for every $2 that we collect and that $2 we feel are dollars that never would be collected, and the track record is there to show that they haven't been and aren't being collected.

Naturally, or historically, the going rate for outside private contractors is between a third to a half, or 33 to 50 percent. The paper that is being sent to our private collection agencies is second referral paper and third referral paper, and that rate approximates about 50 percent and claims even beyond that. So we feel that there is a reasonableness to the 30 percent that is being paid for the collection of dollars that never would have been collected in the first place.

In response to your question about the dollar amount and the number of defaulted loans, taken together as of the end of fiscal

year 1982, the guaranteed student loans, that is, State agency loans, old FISL loans and national direct student loans, there is about 2.4 million loans valued at over $3 billion totally, that are in default. And of that 2.4 million loans, $3 billion, about 1,100,000 loans are national direct student loans, some of which are in default at the institution; others have been assigned to the department and are in default within the department's records.

The amount outstanding in the national direct student loan program at the institution and assigned to the department is over a billion dollars. The guaranteed student loan program has about a $1,300,000 default; about $2 billion totally in default payments have been made to guarantee agencies by the Government. We have about $878 million of that amount as currently outstanding. It represents about 490,000 defaulted borrowers. That is the amount, Mr. Harrison, that is not being collected on, that is the amount that is still outstanding.

I would like to mention that in addition to the department's efforts to collect the national direct student loans and FISL, we were very concerned about amounts owed to guarantee agencies. As you know, the department usually pays 100 percent of the default claim to most guarantee agencies in most States. As of the end of fiscal year 1982 about 4 percent of the total amount of loans made were made under the old FISL program. Over 96 percent of the loans are being made by State agencies. As of September 30, guarantee agencies have paid—that is in 1982—about $1 billion in default to lenders, while the Department has about $896 million, or almost $900,000 paid to lenders under the old FISL program.

What is alarming is the fact that in 1980, the guarantee agencies paid the lendor banks about $1 million in default claims, while in 1982, that amount jumped to $218 million, and we are projecting by 1985 that guarantee agencies will pay lenders about $450 million in default claims. So the growth in that program, in terms of claims paid, is tremendous. One hundred percent of the cost is reimbursed by Department of Education, as you are well aware.

I would conclude by saying that the reviews of the guarantee agency is something I found left merely not considered in some of the management action within the agencies. So last year, we directed every one of our regional offices to review every one of the guarantee agencies every year as a matter of trying to get special attention to claims and collections and developing standards for due diligence. That is being done, and by the end of this fiscal year, we will have a record of review of every guarantee agency by every regional office in every State. We also have forthcoming legislation which we hope will strengthen the guarantee agency's collection efforts.

This concludes our statement. I and Mr. Hastings would be happy to answer your questions.

Mr. SIMON. Thank you.

[Prepared statement of Edward Elmendorf follows:]

PREPARED STATEMENT OF EDWARD M. ELMENDORF, ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION, U.S. DEPARTMENT OF EDUCATION

Mr. Chairman and members of the subcommittee, we appreciate this opportunity to participate in the Subcommittee's hearings on loan collection efforts at the Feder-

al, State, and institutional levels and to discuss the Department's loan collection activities in the student financial assistance loan programs. Before addressing the items specifically mentioned in your letter of invitation, I would like to briefly review the Department's recent accomplishments in this area.

We are proud of the progress we have made in improving our collection efforts on defaulted student loans. In the past year we have implemented a number of major initiatives which have enhanced our performance: full implementation of private sector collection agency contracts; more timely use of Internal Revenue Address Locator Services; improvements in collection system software which have enabled us to more effectively address the new authorities provided by the Debt Collection Act of 1982; development of the procedures to implement the identification, location, and salary offset measures to collect from Federal employees with defaulted student loans; and implementation of administrative procedures which enable us to report defaulted FISL and NDSL assigned borrowers to consumer credit bureaus.

These improvements have contributed to an increase in collections from a level of $46 million in fiscal year 1981, $55.5 million in fiscal year 1982 and current collections at a rate which is expected to result in excess of $70 million for fiscal year 1983.

These all-time high collection figures have been a direct result of the combined Federal-private agency collection activity. As you know, our private collection contractors received their first assigned loans for collection in January of 1982. This cooperative collection activity for example, produced $7.4 million in collections in the month of March alone, which exceeds by $1.5 million the highest previous monthly total.

We are proud of these accomplishments, and we believe that even more can be done by the Department to build on them. In the near future we will be submitting a legislative proposal, The Student Loan Collection Improvement Amendments of 1983, to further improve debt collection activities and default recoveries in the student loan programs. Included in that legislation are proposals which would:

Modify the procedure for disbursing funds under the FISL program. Under our proposal, loan checks payable to the student and the institution as co-payees, would be sent to the institution the student attends. We believe such a policy would provide better assurance that loans are used for educational purposes, and would reduce the potential for aid duplication, and the risk of "no show" defaults.

Expand and modify our current requirements for exchanging information on student defaulters with credit bureaus to provide that State guarantee agencies, as well as the Secretary, be authorized to exchange such information. This would reduce new defaults while improving collections on existing defaults.

Broaden the students eligibility requirements to provide that a student may not receive financial aid if the student owes a refund on a grant or is in default on a loan made under title IV at any institution. Currently, the law provides only that a student in default or owing a refund may not receive further aid at the same school.

Provide that the six-year Federal statute of limitations for filing suit for collection of a loan would apply to guarantee agencies filing such suit. If the applicable State limit is longer, the State law would still apply. Since these loans are Federally reinsured and subsidized, the Federal statute of limitations on recovery actions should be the minimum.

In addition to these Departmental proposals, the Department of Justice recently submitted legislation to the Congress for the Attorney General to contract with private attorneys for the litigation involving Federal debts including student loan accounts. We believe that the threat of prompt litigation in those instances where such action is warranted will have positive effects. In the short term, the United States will be able to secure and enforce judgments in those cases where people have the ability to pay but have simply refused to honor their obligations. In the long term, the deterrent value of prompt litigation will stand as a reminder to those who are tempted to ignore their debts.

Instrumental in the Department's efforts to improve upon its credit management and debt collection activities is its Credit Management Project. Let me provide the Subcommittee with a brief overview of the Project.

Over the years, the means of delivering financial assistance to students enrolled in postsecondary education has evolved into a very complex and time-consuming project. This complexity is a function of the number of student aid programs that have been initiated in response to increased manpower and financing requirements, the complexity of the statute, and the number of different institutional participants in those programs. As this delivery system has evolved, the financial aid community and other participants have regularly asked whether there was not a better way to accomplish the delivery of student assistance dollars. Additionally, an internal De-

partment of Education evaluation and several General Accounting Office reports have questioned the effectiveness and efficiency of the present delivery system.

In an effort to improve the current systems, the Secretary directed the Department's Comptroller to form a Credit Management Project which has the goal to review the current delivery systems and evaluate suggested modifications in and alternatives to the current system. The results of the evaluation will be presented to the Credit Management Board, chaired by the Comptroller, who will present its recommendations to the Secretary.

The objectives of the systems improvement effort include the establishment of: an effective management information system; an auditable financial management system; an efficient funds disbursement system; an effective debt management system; reduced administrative costs to all parties; and effective communication between all participants.

The Credit Management Project has contracted with two professional service organizations, Westinghouse Information Services and Advanced Technology, Inc. to assist with the systems improvement effort. These contracts cost approximately $673,000.

Your letter of invitation raised a number of specific questions with respect to our private collections contracts which I would now like to address.

Since the implementation of the private agency contracts, they have accounted for 22 percent of the total Federal collections ($23.3 million of the total of $104.2 million since November 1981). They currently account for 30 percent of the monthly totals since January of 1983.

At present, the private agencies are responsible for 400,000 accounts valued at approximately $641 million. Their actions on these accounts, on which the Department, schools, and lenders have pursued collections in the past, are currently producing an average of $1.7 million per month on these hard to collect accounts.

Prior to 1981, when the private collections contracts were signed, Federal collectors pursued the following collection efforts:

1. Attempting to locate the debtor through any or all of the following sources: Internal Revenue Service's Address Search Service, Manual review of the file for leads; Postal tracers; Directory Assistance; Department of Motor Vehicles; and Other manual efforts on the part of the collector.

2. Periodic mailings of default notices, bills, and final demand letters to defaulters.

3. Telephone contact with the defaulter to initiate repayment if a home or work telephone number could be obtained.

4. Preparing and forwarding of accounts to the Department of Justice's U.S. Attorneys for litigation on those costs where the debtor had refused to pay, and met the Department of Justice's requirements for litigation.

The private collection agencies currently under contract to the Department of Education are required to perform all of the actions listed above, with the exception of the litigation step. Accounts which are candidates for litigation must first be returned to the Department of Education before being forwarded to the U.S. Attorneys.

Between fiscal year 1977 and fiscal year 1980, the Department of Education collected $134.5 million in defaulted student loans. The total portfolio or value of accounts being handled by the Department as of September 30, 1980 (the end of fiscal year 1980) was approximately $900 million.

The private collection contractors have received accounts valued at approximately $641 million, with collections totaling approximately $23.3 million through June 30, 1983. While this rate of collection might appear low when compared to the Department's efforts prior to 1981, two points should be made.

All accounts transferred to the private sector agencies are accounts that the Department of education, as well as, schools, lending institutions, and/or other private collection firms have been unable to collect in the past. Many are very old accounts. NDSL's must, by law, be in default for two years before they can be assigned to the Department. The accounts transferred to the private agencies are accounts that would eventually be written-off if collections can not be effected by the private agencies. In total, $7,026,314 has been paid in commissions to the private agencies. That represents 30 percent of the $23.3 million those agencies have collected.

Our typical collection experience is that debtors do not usually pay their entire obligation in full when we are able to reach them. Instead, we wind up with repayment schedules in most cases. This leads to what is known in the trade as an "annuity" effect. That is, the work expanded today in contracting and negotiating with the borrower continues to bear fruit for some time into the future. Thus, the typical

curve for a collection firm tends to be a curve accelerating over time as these monthly payments continue to accrue.

In order to better illustrate the effectiveness of the overall strategy that we have implemented, we have attached tables to our prepared testimony which reflect relevant statistical data on the success of the private agencies.

Specifically, based on the average monthly balance, the charts illustrate actual dollars and percentage of dollars collected by the private agencies as compared to the total dollar value of all accounts transferred, the percentage and dollar value of all accounts which the private agencies have converted to a current repayment status, and the percentage and dollar value of all accounts on which the private agencies have ever received a payment.

In response to your question as to the dollar amount and number of defaulted loans, through fiscal year 1982, the latest year on which the Department has official statistics, the total number of student loans in default in the GSL and NDSL programs is approximately $2.4 million, valued at approximately $3.02 billion. The NDSL program has experienced nearly 1.1 million defaults with a value of $1.02 billion. In the GSL program there have been slightly more than 1.3 million default claims representing $2 billion in default payments. Currently, we estimate that approximately $887 million of that amount is still outstanding, representing an estimated 490,000 defaulted borrowers.

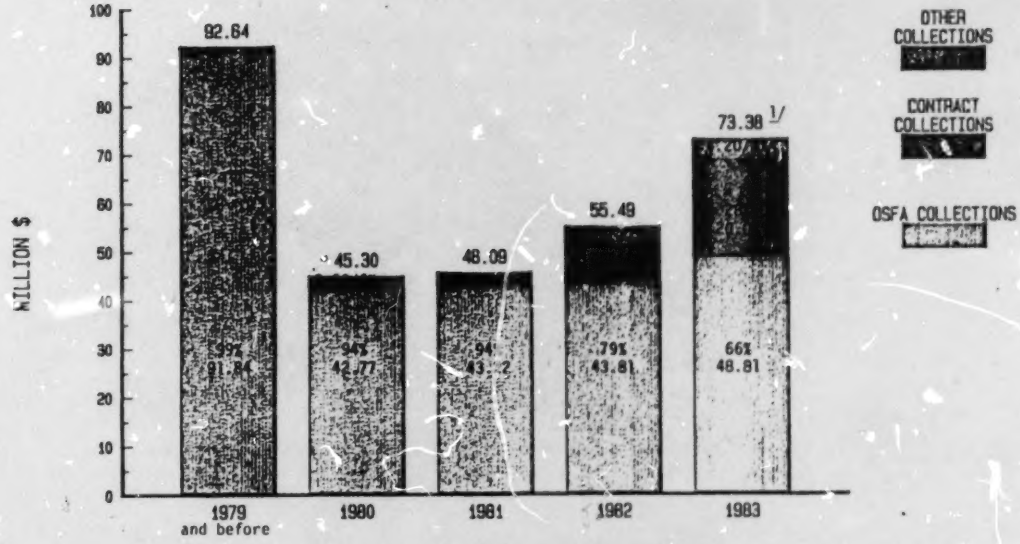
I should note that while we are all concerned about the efforts of the Department under NDSL and FISL, we are also very concerned about amounts owed to guarantee agencies—on which the Department generally has paid 100 percent of the default claims. In the early 1970's, FISLP accounted for more than 50 percent of the annual GSL loan volume (in dollars). However, in fiscal year 1982, FISLP was only 4 percent of the annual GSL volume.

As of September 30, 1982, guarantee agencies have paid a total of $1.09 billion in defaults to lenders, while the Department has paid $896 million to lenders under FISLP. Because of past increases in GSL loan volume, default claims paid by guarantee agencies and reimbursed by the Department are rising rapidly. In 1980, guarantee agencies paid lenders $107 million in default claims. In 1982, that figure had risen to $218 million. We project that in fiscal year 1985 guarantee agencies will pay lenders $450 million in default claims. Again, about 100 percent of the cost will be reimbursed by the Department.

We will be focusing increased efforts on the guarantee agency programs. Each agency will be reviewed in fiscal year 1983 with special attention being given to claims and collections and to the development of standards for due diligence. In addition, the legislation we will be submitting will contain a number of provisions to strengthen and support guarantee agency collection efforts.

Mr. Chairman, I hope that this testimony has been informative in identifying the Department's recent and proposed activities to improve collections in the student aid programs. I will be pleased to respond to any questions the Subcommittee members may have.

PERCENTAGE OF COLLECTION DOLLARS, BY SOURCE, FY'79-FY'83



S. WEISS
JULY 27, 1983

1/ The figures in this column are a projection based on performance data from the nine months of FY'83.

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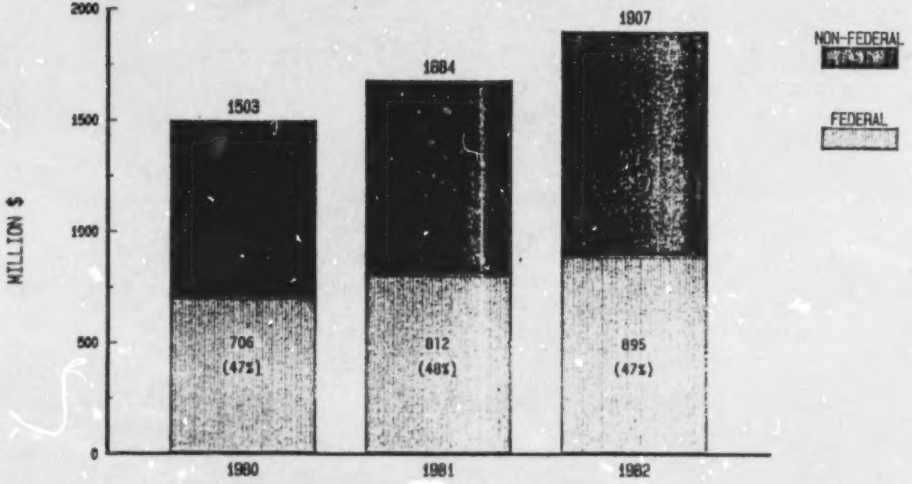
TOTAL DEFAULTS OUTSTANDING 1/
FEDERAL VS. STATE GUARANTEE AGENCIES AND NON-FEDERAL NDSL, FY 1980-1982



S. WEISS
JUNE 20, 1983

1/ These figures do not include cases in litigation or write-off. NDSL figures are current through the third quarter of the Fiscal Year. It is assumed that the Federal share of NDSL is 37%.

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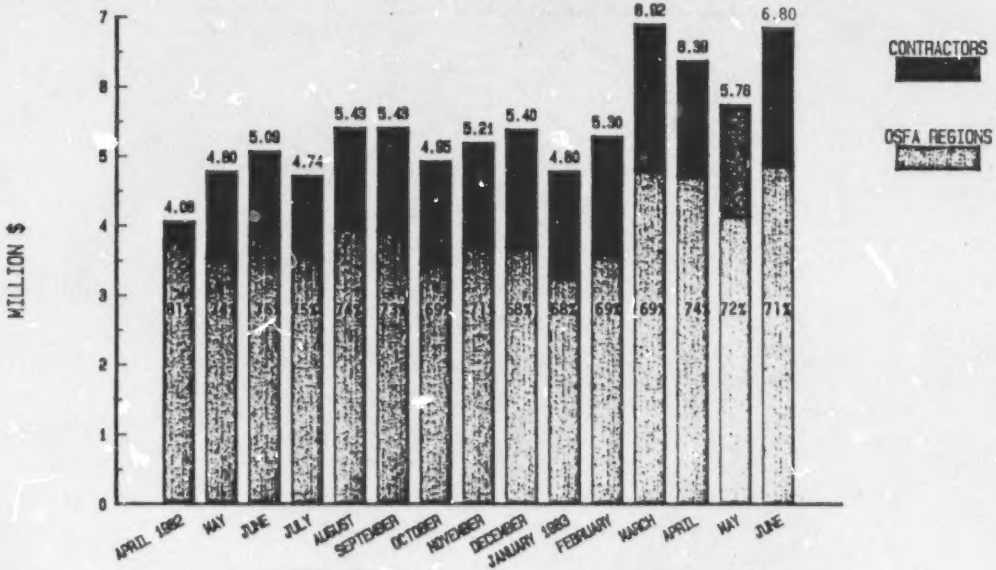
PERCENTAGE OF MONTHLY NDSL/FISL COLLECTION DOLLARS, BY SOURCE, APRIL 1982-JUNE 1983



S. WEISS
JULY 28, 1983

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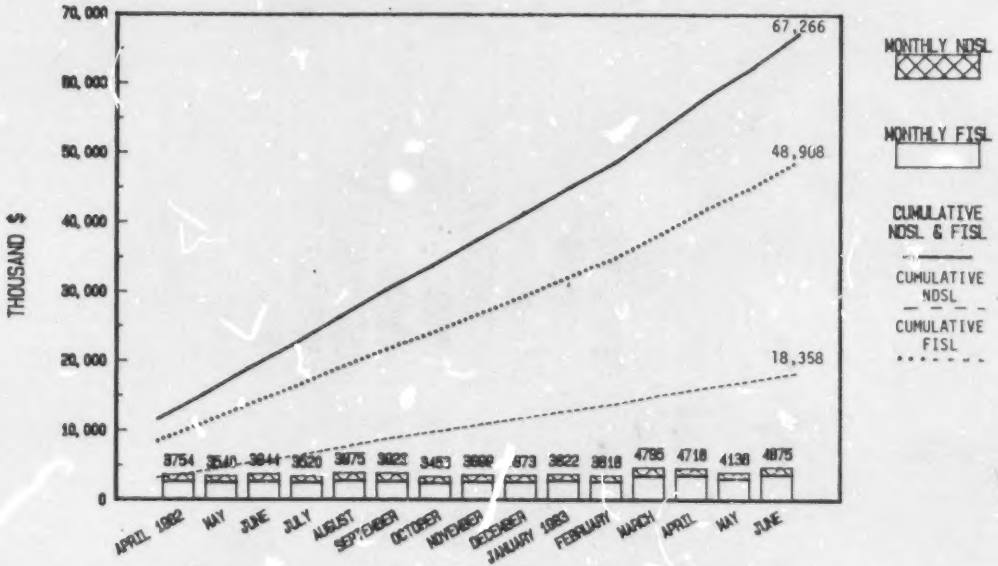
TOTAL REGIONAL OFFICE COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



S. WEISS
JULY 28, 1983

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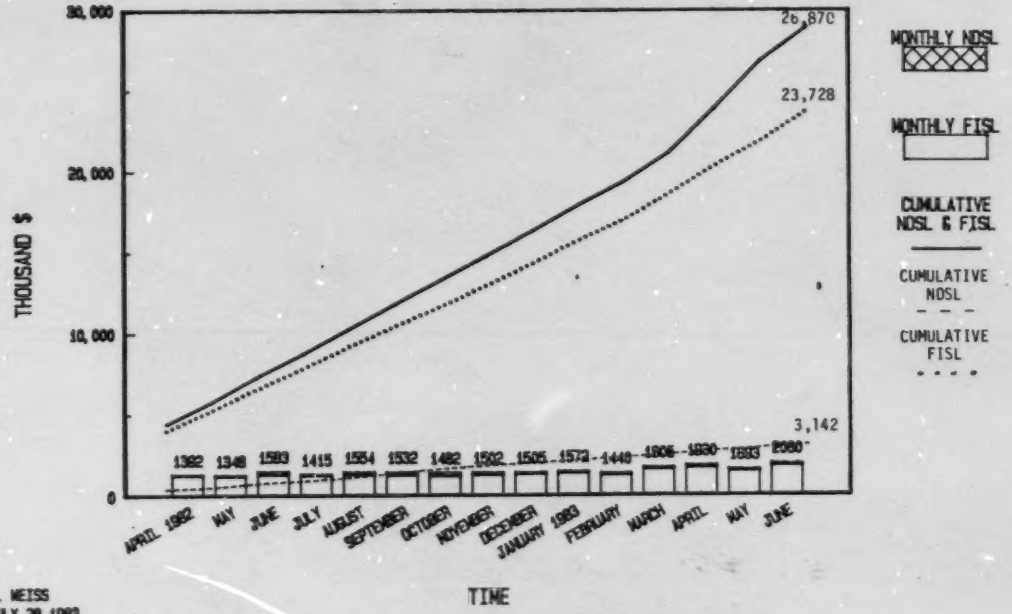
SAN FRANCISCO REGIONAL OFFICE COLLECTION DOLLARS BY PROGRAM, APRIL 1982-JUNE 1983



S. WEISS
JULY 28, 1983

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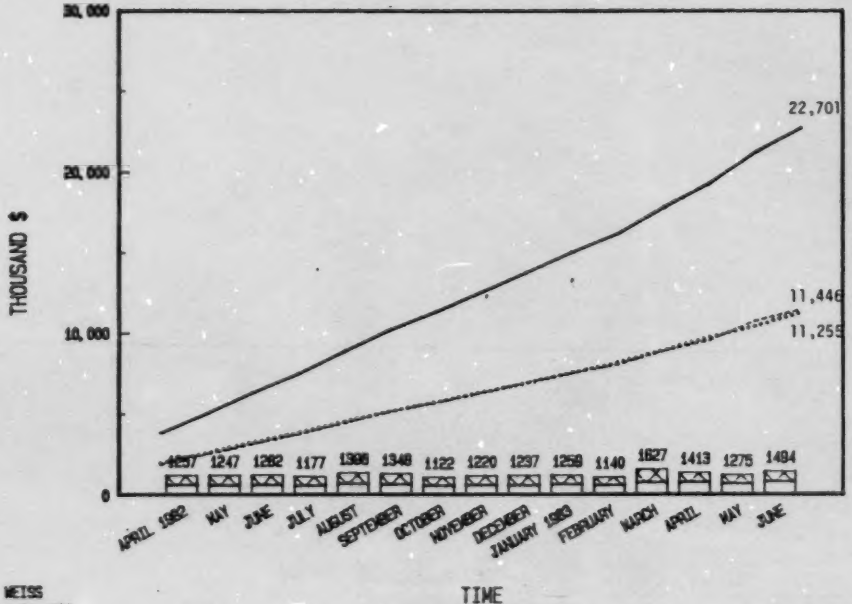
ATLANTA REGIONAL OFFICE COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



S. WEISS
JULY 28, 1983

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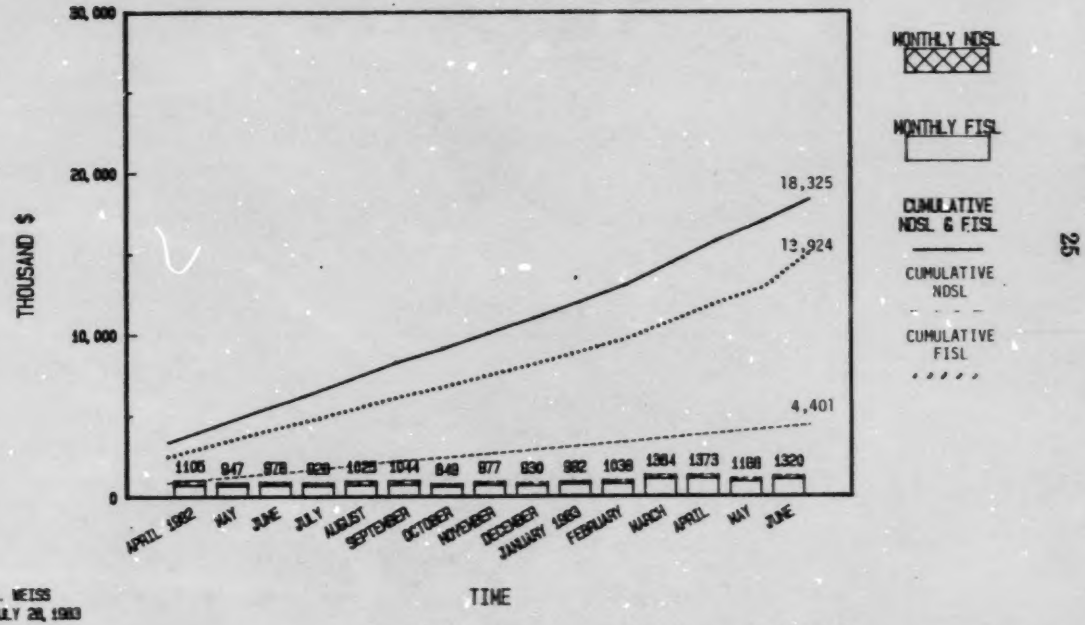
CHICAGO REGIONAL OFFICE COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



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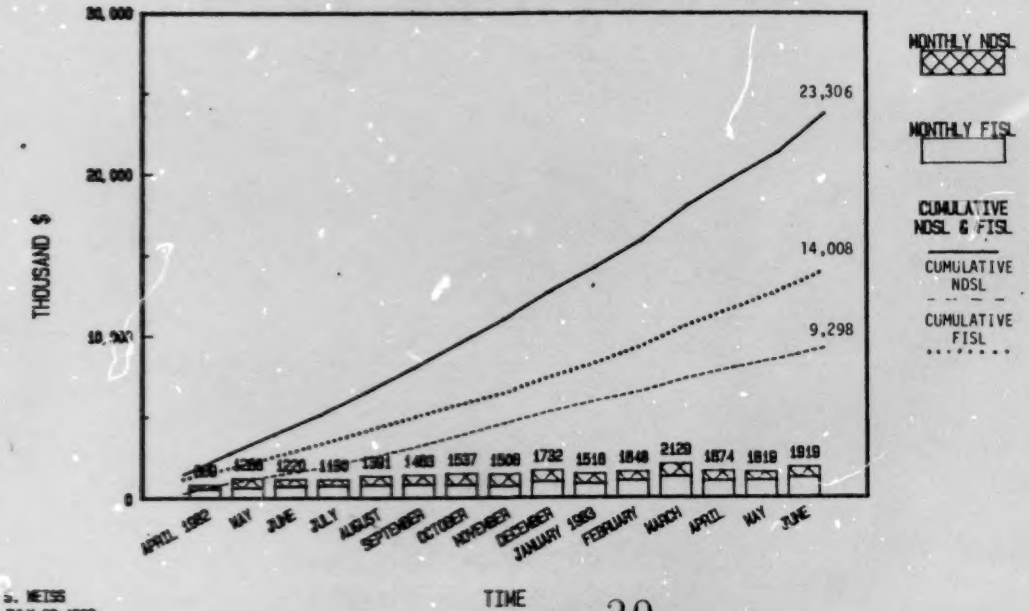
TOTAL CONTRACTOR COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



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JULY 28, 1983

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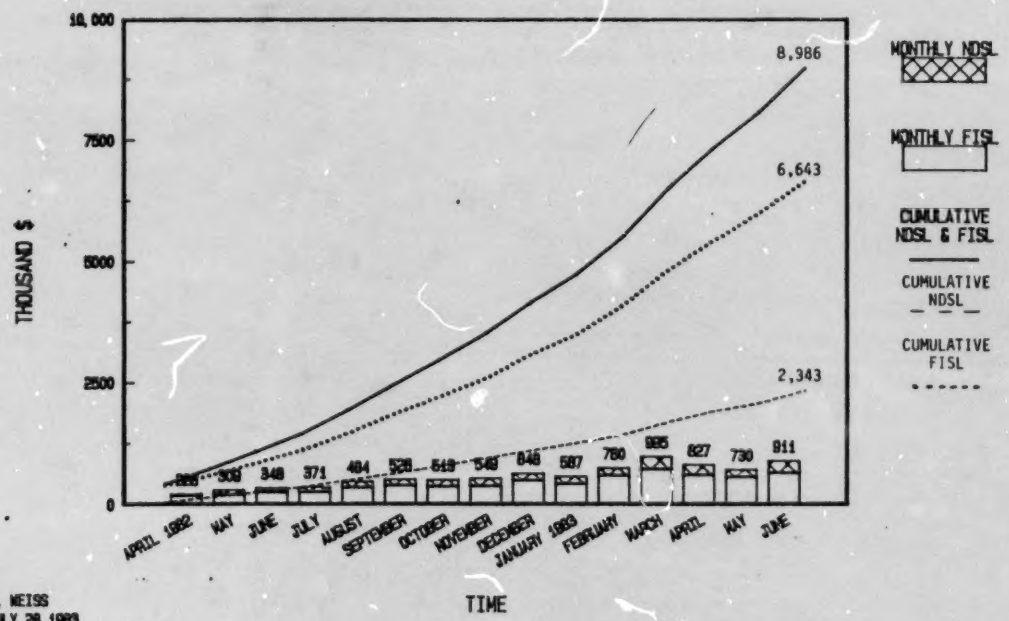
SAN FRANCISCO/PAYCO CONTRACT COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



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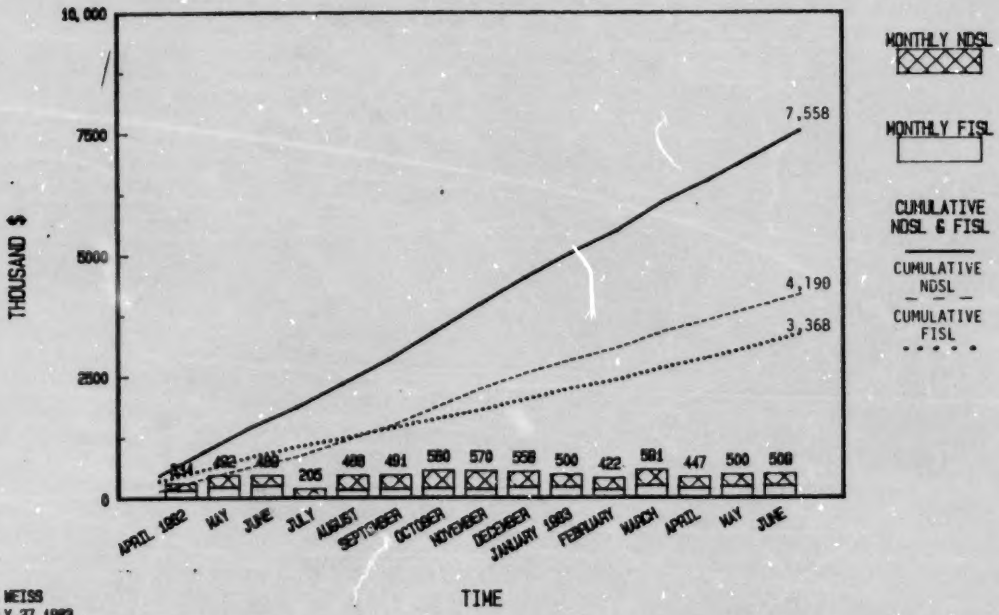
ATLANTA/G.C. CONTRACT COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



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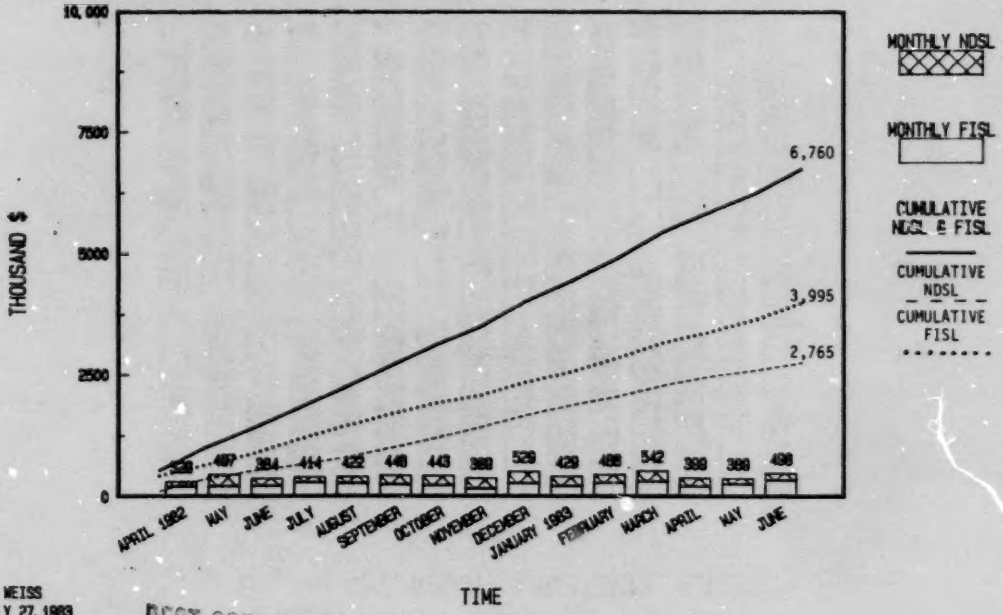
CHICAGO/G.C. CONTRACT COLLECTION DOLLARS, BY PROGRAM, APRIL 1982-JUNE 1983



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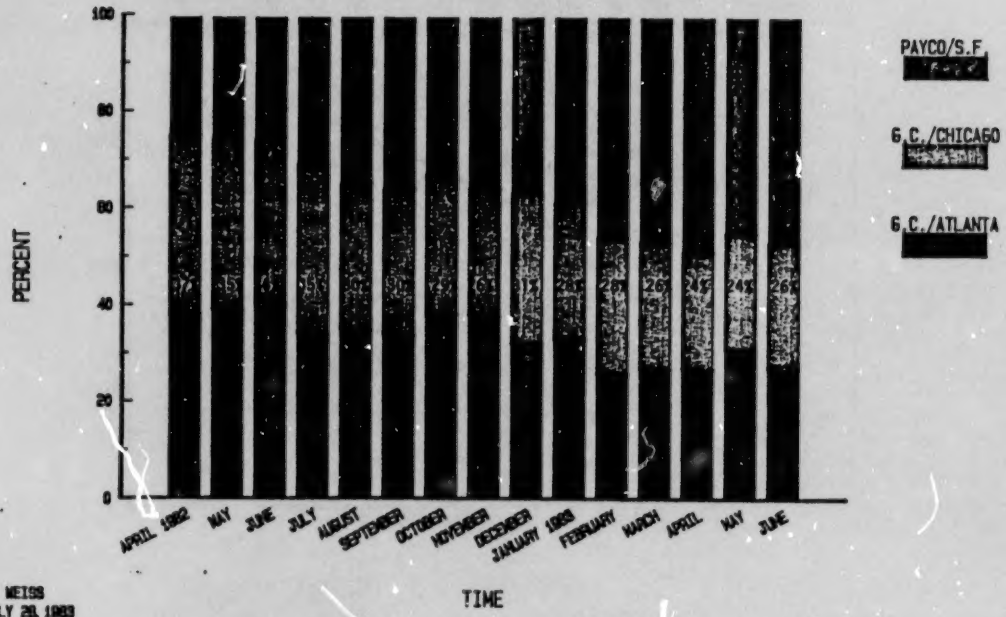
PERCENTAGE OF CONTRACT DOLLARS, BY AGENCY, APRIL 1982-JUNE 1983



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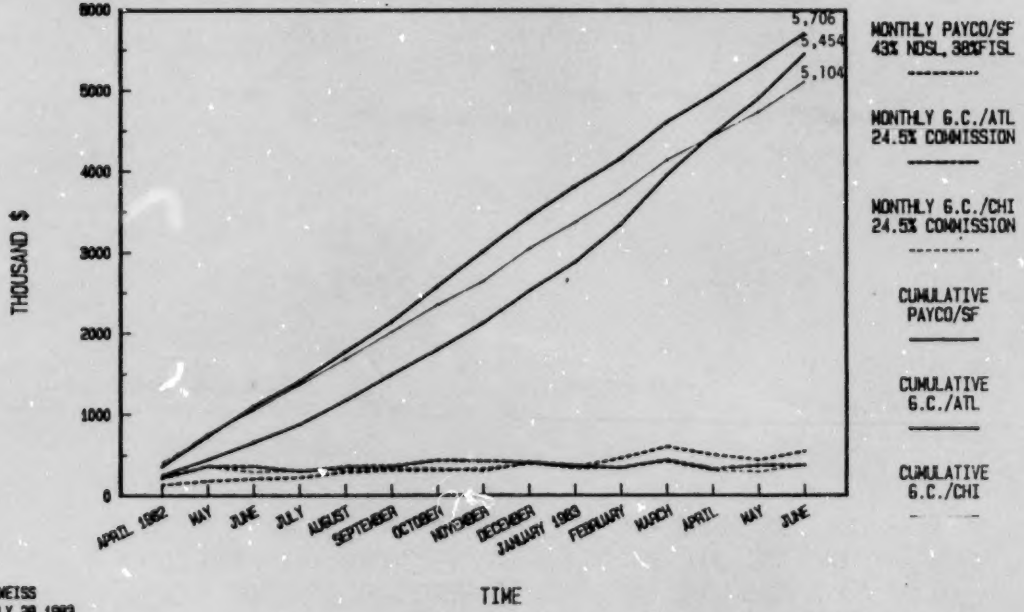
TOTAL CONTRACTOR COLLECTION DOLLARS, NET OF COMMISSIONS, BY REGION, APRIL 1982-JUNE 1983



S. WEISS
JULY 28, 1983

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AVG MONTHLY BALANCE OF DOLLARS COLLECTED BY PVT COLLECTION AGENCIES, AS A PCT OF THE DOLLAR VALUE OF ACCTS TRANSFERRED, AS OF JUNE 30, 1983

G.C./ATLANTA

G.C./CHICAGO

PAYCO/S.F.

TOTAL PRIVATE COLLECTIONS

S.WEISS
JULY 29, 1983

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AVG MONTHLY BALANCE OF NUMBER OF PVT AGENCY 1/ ACCTS PLACED INTO REPAYMENT, AS PCT OF THE NUMBER OF ACCTS TRANSFERRED, AS OF JUNE 30, 1983

G.C./ATLANTA

G.C./CHICAGO

PAYCO/S.F.

TOTAL PRIVATE COLLECTIONS

S.WEISS
JULY 29, 1983

1/ In Repayments accounts are those accounts on which a payment has been received within the last 120 days.

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Mr. SIMON. One of the questions is, I confess to a little provincial bias here, since the Chicago office is one of those that is being phased out, or is being attempted to be phased out. There is a charge made by some of the employees involved that what is happening is you are just phasing down the Government collection end of it to save some dollars. It costs a heck of a lot more dollars than you are saving, and you end up turning a great deal more over to the private collection agencies. I guess my question is, is that true?

Mr. ELMENDORF. No, that is not true. We have a record—if you have the chart there, that shows the history of collections within the Department since 1979 and before, and subsequent to that, you will see that the reduction of 700 employees back in 1981, as the secretarial decision has not in fact resulted in less Federal collections. The increase has been actually in both categories, Federal collections a slight increase, and contractor collections, a significant increase, and even more significant increase is expected in 1984.

So, the growth in amount of dollars collected is not at the expense of dollars left uncollected by Federal employees, but rather in accounts that couldn't be collected in the period of time that those employees had the accounts.

Mr. SIMON. What is that old other collection? What is that?

Mr. ELMENDORF. We have collections from other payments of BOEG, we have collections from program reviews done on institutions that are not in compliance—Cuban loans, SLIF loans.

Mr. SIMON. What you are doing is not in an attempt to meet a mandated target, reducing employees in order to say you have reduced the number of employees and just shifting collection over to the private sector?

Mr. ELMENDORF. Let me go back one step. You mentioned we were closing the offices. That is not an accurate statement. What we are doing is shifting the loan collection function that exists in three regional offices—San Francisco, Chicago, and Atlanta, into the most productive of our offices, which is the San Francisco office, leaving the office intact and leaving the other major functions in the other offices in Chicago and Atlanta fully intact.

In fact, we expect greater productivity in the area of program reviews, and in lender reviews and guarantee agency reviews for those employees out there. Chicago, as you problably are well aware, is one of the regional offices that has a high number of institutions that should be audited on more than just one or two times every 5 years, and we would like to improve the review of the institutions out there to find out if they are complying with the regulations and the statutes and whether there are liabilities that we are totally unaware of. We can't do that now with the burden placed on 3 regions to do major collections and 10 regions to do all of the program reviews and lender reviews.

Mr. SIMON. Are you saying that those employees there now are going to be shifted to auditing functions?

Mr. ELMENDORF. We are going to make no effort whatsoever to tamper with any of the full-time permanent employees. You heard testimony before that there are temporary employees, and we are dealing only with temporary employees at this point who have been given no expectation of full-time permanent service. In fact,

under the law, they are there only for a temporary period of time. I think they have been there for 3 years at least, or 4 years.

Mr. HASTINGS. Some of those employees have been there for longer than that. They were hired the first time we had the term employment authority as well.

Mr. ELMENDORF. We expect to take no action against those employees in fiscal year 1983.

Mr. SIMON. You expect to take no action as a result of the amendment in the Senate——

Mr. ELMENDORF. We expect to take no action against those employees at all in fiscal year 1983. We do have a work-force reduction number that I think you heard testimony on before that affects the whole Department, affects the SLIF funded employees—SLIF, the student loan insurance fund, out of which these collections are paid. And we do have targets for 1984 in that area that we are going to have to meet and my expectation is there will be some activity in the area of workload reduction in the fiscal year 1984 year, as a result of meeting these targeted figures.

Mr. SIMON. And you consider the Senate amendment and Senate report language simply to be a mandate for the balance of this fiscal year?

Mr. ELMENDORF. I consider it to be informative instruction to the Department to not tamper with, I think the number was 382, in the fiscal 1983 year.

Mr. SIMON. And as of October 1, you are free to do whatever you want.

Mr. ELMENDORF. As of October 1, I would think that we could continue whatever management action that is necessary as long as the numbers are known. We will get a new set of figures from the Office of Management and Budget before fiscal year 1984. Those figures are not yet known. There may be an increase; there may be no increase; and there may be a continued reduction. But we are dealing with a decision that was made by the Secretary on the allocation of resources within the Department and we are supporting that decision.

Mr. SIMON. What about the question about centering everything in one end of the Nation, which means the Federal Government—loses some efficiency, phone costs, and other things.

Mr. ELMENDORF. I think I will let Mr. Hastings deal with the technical part of it, but basically you remember the collections claims both were in all 10 regions at one time and the chart shows that at the time when they were in all 10 regions, we collected totally about $92 million. Since we have moved to three regions and consolidated, we have maintained the Federal collections and at the same time improved them slightly.

We also have improved significantly outside private contractors' collections. We now have a great deal more data on which to base not only the location but the dollars collected per collector, for the last 18 months both private and Federal. And/or to make uniform management decisions our sense is that we have very good productivity data to select out the most productive of the regions in terms of their collections ability.

The location doesn't seem to have an effect. In fact, it might work to our advantage because on the west coast our collection ac-

tivity record shows we are able to contact people at home from work better than we are at work, and the 3-hour difference in time enables our collectors on the west coast to reach east coast delinquent-defaulted recipients much more easily.

Mr. SIMON. So, as I understand your graph here, 1979, that is cumulative total?

Mr. ELMENDORF. That is everything.

Mr. Hastings.

Mr. HASTINGS. Yes sir. On your point concerning San Francisco, in the package of charts we gave you, I think the fifth one there shows our San Francisco regional office collection dollars, and that is backed up by Atlanta and Chicago, they are all to the same scale, as it indicates. The general line there, these do require a little interpretation. Green line at the top is cumulative total. The dotted red and blue lines underneath are subsets of the green line and represent the FISL and NDSL proportions. Then the bars down at the bottom are actually monthly figures.

The important point is that we had collected $26.8 million during the period of time indicated in our San Francisco regional office, while at the same time we collected $22.7 in Atlanta and $18.7 in Chicago.

A fascinating thing to look at is the next series of charts right behind that which shows the experience with our collection agencies. Now, Mr. Horn is testifying—I just asked him to be sure I was correct in my facts—the PAYCO contract which is located in Oakland actually does none of their collections anyplace else in the country except from Oakland. And you will note that of the three contractors, they have collected the most money.

In fact, I believe I am correct, GC for both of their Atlanta and Chicago contracts, they do use other locations than the two headquarters cities. I know they use Baltimore and Houston, for instance, as two cities from which they do actual phone contracts. You are not going to collect from people unless they are home and the time advantage works to our advantage in that regard, I believe.

Obviously, there are some increased costs with respect to telecommunications from there, but after divestiture of AT&T, I am not sure what that is going to mean with respect to the way those charges are going to break out.

Mr. SIMON. One of the complaints from the private agencies, when I talk to them, is the fact that two collections for all practical purposes have been given all the business. No. 1, why only two collection agencies, and No. 2, was there a competitive bid basis, or was it political favor? What was the basis for it? And then in the same connection—I have a memo and this is in contradiction to something that Ed Elmendorf said—I am not sure this is accurate, but my memo says that PAYCO receives 43 cents per dollar from the department for collection on the NDSL, and 38 cents on GSL. The other collection agency only receives 24.5 cents. Yet when we switch to San Francisco, what we are going to do is end up paying more money to the higher cost credit agency.

Now, that is a whole series of questions.

Mr. ELMENDORF. Let me just answer the first part of that. The process on the decision was made by the Secretary in March 1981

to go with outside private collectors. Based on a Booze, Allen, Hamilton study which concluded, after extensive assessment that they could find no significant difference between Federal collectors or outside contract collectors, and we did have a track record of two pilot contracts in two regions.

PAYCO was one of the pilot contractors. We used that experience and made the decision; it went through a competitive bid process. Specified in the request for the proposal was that we had to have more than one contractor.

In fact, it was at least two different contractors had to be available essentially for comparative purposes and cost purpose to look at the 3-year track record of both of them to see if there was a significant difference.

We can't at this time give you the kind of information I know you would like relative to a comparison between the two or the productivity of the two because we are in negotiations right now for the third year of the contract, and we are in a process of deciding a number of management decisions such as the number of accounts and to whom and for how much and the negotiating at essentially a new price.

The 30 percent is the average amount of commission paid out for the total amount of dollars collected. You are specifically correct in saying that we had contracted for 38 and 42 percent with PAYCO and that essentially was based on their experience with the quality of the paper that they had for their region, which was the San Francisco region.

We have been, I should say, in a unflattering way, very pleased with PAYCO's performance in terms of the record before you; it shows clearly that they are doing the job in collecting the dollars and they are improving significantly.

Beyond that, I don't think I would like to make any further commitment except the track record in the last 18 months has been a good one. Mr. Hastings can deal with it.

Mr. HASTINGS. I would add one point, a couple points. If I recall, it was a competitive process, it was not political favor, and in all three cases, there are three contracts, although there are two contractors, all of them were awarded to the officer who had both the best technical proposal and the lowest price.

The package that you have there, the third paragraph from the end, I believe, it is headed total contractor collection dollars net of commissions; this is the net; this is the bottom line gross collections minus the commission paid and the rate to get it straight.

It is 43 percent for NDSL and 38 percent for FISL paper for PAYCO for the first year of the contract.

Down at the bottom, we have the monthly collection figures and the three lines at the top are cumulative.

The interesting thing you will notice is that in January 1983, despite the fact that they have a commission rate which is about 80 percent higher, the net back from PAYCO exceeded that of the other two contracts and continues to exceed them for the last 6 months.

And on a cumulative basis, as you see, they passed the Chicago contractor, cumulatively back in March, and are fairly close to exceeding them in Atlanta as well.

Those are the kinds of considerations we are looking at. There is a difference between cost and price and 5 percent of nothing is still nothing, if we don't collect the money.

Mr. SIMON. So I understand the process, PAYCO bid in a sense 43 percent and 38 percent and that was the low bid?

Mr. HASTINGS. That is correct.

Mr. SIMON. And the others bid 24.5 percent and that was the low bid?

Mr. HASTINGS. That is correct. There were three separate competitions held. There was a provision in the RFP that no offerer could win more than two of three contracts that were being let.

We wanted to be sure we would have at least two different contractors. One other point about why only two, though—which we didn't address—we discussed that one at great length within the Department.

There were those who argued we ought to let 1,000 flowers bottom in this area and certainly we did want to have the maximum amount of competition in this area.

We are also faced with some realities, however. We were the—I believe I am correct we were the only agency that had separate authority before the Debt Collection Act to use private collection agencies.

There have been all sorts of horror stories about the use of collection agencies and people calling late at night and harassing phone calls and this sort of thing. We obviously were sensitive to those issues and we wanted to be certain that the people who were acting as Federal agents in a fairly delicate area were representing the taxpayers in a professional manner, and we decided right upfront that these were going to be live-in contracts as far as we were concerned. We were going to be onsite as long as they were in business every day, because there are also some decisions which we could not delegate on the contractor including things like cancellation, compromising the debt if we had an offer from the debtor, those kind of issues which only a Federal employee could decide.

So it was necessary for that purpose as well.

That obviously presented us with some logistical problems, because we couldn't have dozens of contractors involved in the process.

We now have a couple of experience. We have generally been pretty well satisfied so far as area is concerned, we have virtually no documented complaints from these, and we will be offering some additional paper on the street later in the year, and we expect that there will be small business set-aside for some of those.

Mr. SIMON. Mr. Packard.

Mr. PACKARD. Thank you, Mr. Chairman.

Let me follow up a little bit on the private contracting. Some of the questions were answered.

Is your general plan, Dr. Elmendorf, to put out more and more of the collection process to private contractors?

Mr. ELMENDORF. The plan is at this time, and in the foreseeable future, to have a mix between Federal collectors and private collectors. It is a healthy mix for this reason.

For those employees that are civil servants, we are giving them essentially the best paper to look at first, and they have 120 days to look carefully at that paper and try to get it into repayment.

Failing that, we want an alternative. An alternative has been to use private collectors. The track record for 18 months has shown they do in fact collect paper that couldn't be collected by Federal employees.

We think that the Government is getting the best deal, it is getting paper that otherwise would have been written over, getting paper and dollars back into the Treasury that never would have been there, and the Federal employees are getting 100 cents on the dollar, if you will, for paper that is a little bit easier to collect on.

Mr. PACKARD. How long are your contracts with those collection agencies?

Mr. ELMENDORF. They are 3 years, I believe, and they expire in 1985.

Mr. PACKARD. You review their performance contract before they are renewed?

Mr. ELMENDORF. We are doing that right now.

Mr. PACKARD. You mentioned in your testimony, the no-shows, those that do not come and enroll in the school after they receive a loan, what percentage of defaults can be attributed to that?

Mr. ELMENDORF. It is very difficult to tell. That kind of data is not collected by the school nor is it collected by the guarantee agency, and these are primarily pieces of information that the Government does not burden the institution collecting.

Mr. PACKARD. I am wondering if there couldn't be a better processing system to screen that a little more closely or to tie loans, timewise, when the money is distributed to actual enrollment procedures or other procedures that would tighten that up somewhat. Any studies on that?

Mr. ELMENDORF. That is a main part of the public hearing that we held on the credit management effort to develop an alternative delivery system. Just simply to answer your question, the purpose of the alternative delivery system is to try to remedy the deficiencies in the current system so that we can, up front, before the dollars are every put out in the hand of the students, have as many checks and balances in place to assure ourselves that the funds are going to be used for educational purposes.

Mr. PACKARD. I would assume on those kinds of loans, that if repayment doesn't take place within a matter of weeks, after they have made the decision not to enroll, they are virtually uncollectible because of the reasons that perhaps some of those loans were sought after whether they were legitimate or not.

But if they don't make a conscious effort to repay, and obviously it is not going to be used for the purpose for which it was lent, then I think we would have to question the motives of the individual that received the moneys.

Mr. ELMENDORF. Excuse me. There is one other prevention in place, it is in place in the guarantee agency. Each State has the option of a copayee arrangement, where the student and the institution are both on the check and both need to sign it. That is one way, I think, to take the risk out of that, and the private sector

task force report is also recommending multidisbursements, and that is under consideration now by the Department.

Mr. PACKARD. I think that is very important that you don't disburse all of the money before it is needed. It ought to be disbursed as need arises, and that would be a lot more control, it would appear to me.

In your collection procedures, and techniques, do you consider rewriting or reconstructing the loans in the case where it is needed, or do you just go after the money?

Mr. ELMENDORF. You mean someone who is in dire straits?

Mr. PACKARD. Someone is in default, you are able to communicate with them, is rewriting a loan or reconstructing one of the alternatives?

Mr. ELMENDORF. What they do is they temporarily go out, go into delinquency, they go into default and we get them back on schedule again, at a later time. That is primarily true of the NDSL accounts. Is that true in the other accounts as well?

Mr. HASTINGS. In both programs, if the borrower has a problem, he can go to the school or lendor and ask for forebearance or possibly even having the note recast.

Once we get the paper, however, they are long since past that point. We are required to go after the full amount as the first step in the process. If there are legitimate reasons why people are unable to pay, however, we do agree to payment terms in probably the majority of cases at this point.

Mr. PACKARD. You mentioned that there is about a little over $3 billion that is in default at the present time, which is a substantial amount. Is the money that you have available for loan purposes, in the current or succeeding years affected by the recovery rate, so that the $3 billion that may be in default now is not available for loan purposes, or does the Government come in and add to your pool on an ongoing basis?

Mr. ELMENDORF. Yes and no.

No, it is not hurting or endangering the amount of capital available under the guaranteed student loan program or any amount of money that has been assigned by an institution to the Department.

However, for a portion of the $3 billion, the National Direct Student Loan is defaulted paper at the institutions, that would come back to the institution if paid upon, put back onto the revolving fund and recycled.

So that is true that for the institutions they are to collect, they are risking having additional funds available to new students from those funds repaid.

Mr. PACKARD. I suppose there would be a penalty for students who are innocent of the problem, those who are seeking loans, new students coming into the loan structure, if we set up some kind of a program under which the number of dollars available for future loans would be dependent upon the recovery rate of existing loans a program structured so that if they don't collect the money, then they have that much less in the Department.

I suppose that would penalize the program rather than really get at the heart of the problem, is that correct?

Mr. ELMENDORF. There is regulatory action that was proposed by the Department that is just beginning to work, and we looked at it

from a different perspective. Any institution that had a default rate in excess of 25 percent was precluded from receiving any new Federal capital.

There were 630-some total institutions in that category. There are about 420-plus of those institutions that were receiving capital that were denied receiving that capital because their default rate was in excess of 25 percent.

That is another way, without jeopardizing the flow of funds, of putting pressure on the institutions, too.

Mr. PACKARD. That is the concept I was thinking of, only that is an all-or-nothing kind of arrangement. I am wondering if you just subtract from the eligibility of that particular institution what their collection rate default rate would be.

Mr. ELMENDORF. We do that. I should have stressed that 25 percent is the denial between 10 and 25 percent the institution is penalized by not receiving new capital, the amount they should have collected, which they didn't.

Mr. PACKARD. That was the point I was wanting to make. I have taken more time than I should. I appreciate that.

Mr. SIMON. Mr. Penny.

Mr. PENNY. Mr. Chairman, I am interested in finding out the overall default rates for various programs.

Mr. ELMENDORF. OK. The guaranteed student loan program, which is the largest of the programs—I believe you will find a statement in the testimony that breaks this down—it is 11.5 percent, the default rate. That is based on about $2 billion in State agency and FISL paper, in default over about $17.3 billion of mature paper—that is, paper that is eligible to be paid on now.

On the National Direct Student Loan, the overall program default rate is about 15.9 percent. That includes all the money that the institutions have due them plus the amount of money due the Government on the basis of paper that was assigned to the Government from the institution.

That comes to over $1 billion of about $6.4 billion in the matured paper. The institutional loan of that 15.9 percent has about a 10.5-percent default rate. On $671 million, in default at the institution, over about $6.4 billion overall.

In other words, the institutional portion of the $1.2 billion outstanding is $671 million at the institutions and the rest is in the hands of the Department to collect.

The difference in default rate is 10.5 at the institution and 5.4 in the way of paper assigned by the institution to the Department for us to collect ourselves or, as one person had phrased it, to be the collector of last resort.

That is essentially what we see our role as being.

Mr. PENNY. Do the collectors at the Department have the authority to settle an outstanding loan, defaulted loan, at a lower rate, at a lower amount just to say, "We will write this one off?"

Mr. ELMENDORF. On the basis of a genuine dispute in numbers?

Mr. PENNY. Write this one off at an amount lower than that.

Mr. ELMENDORF. Just arbitrarily?

Mr. PENNY. Can they negotiate, do they have the authority?

Mr. ELMENDORF. They have the authority to negotiate.

Mr. PENNY. To settle that loan that is in default at a lower amount than is owed.

Mr. HASTINGS. They have authority within the statute and the joint standards promulgated by the Department of Justice and GAO.

Mr. PENNY. What are those parameters?

Mr. HASTINGS. Well, you have to look at the time value of the money. For instance, if he owes you $12,000 and comes in and offered to pay you $10,000 on the spot, to compromise 2,000 dollars' worth of interest, you have to think long and hard about that one. If there is a dispute with respect to the quality of the education they received, we sometimes are forced to recognize realities in those, particularly in the case of closed schools, for instance, or cases where there has been fraud involved, on the part of the school.

Small balance accounts, you have to look at the cost of collecting versus the expected return. Often we will take less. Generally, we try not to compromise the principal, however.

Mr. PENNY. Do you have written criteria that——

Mr. HASTINGS. Yes, sir.

Mr. PENNY. Can that be submitted for our records?

Mr. HASTINGS. Yes, sir.

Mr. PENNY. Do private collectors have the same latitude?

Mr. HASTINGS. The collection agencies have the authority that we have given them, and we have given them guidelines with respect to what they can discuss on the telephone while they have that debtor.

They do not have the final approval authority, that must be done by a Federal employee on site.

Mr. PENNY. The private collectors or private collection agencies would have authority to settle a loan at a lower amount than is actually owed, but they can't do it unilaterally, they have to have that approved by the Department.

Mr. HASTINGS. They have the authority to discuss the acceptance of it. They do not have the authority to make the decision.

Mr. PENNY. You explained to Mr. Packard that the private collectors can initiate a rescheduling of a loan in order to assist the repayment. Do you have any kind of chart that shows us, based on those loans, that have now been rescheduled, how much will come in over the next few years?

Mr. HASTINGS. Yes, sir.

Mr. PENNY. I don't think that has been submitted.

Mr. HASTINGS. It is not in this chart. In fact, I am having——

Mr. PENNY. That would be helpful as we track the success of the private collection agencies. It would be good for us to know how much is just building on their past success and how much is new success.

Mr. HASTINGS. We can tell you the total value of all of the accounts that are currently in repayment, which is really the question you are getting at, I think.

Mr. PENNY. Are we whittling away at the backlog on defaults?

Mr. HASTINGS. I believe so, yes, sir.

Mr. PENNY. Can you give us more specific data on that?

Mr. HASTINGS. The way we got into this business in a big way, back in the late seventies, when we had over 1,000 term employees in 10 regional offices, was that this was simply an area which had been grossly neglected by the Federal Government for years, the paper just piling up and piling up, and every time an appropriation was made by the Congress to hire collectors, somehow those positions seemed to disappear someplace before they got down to the people responsible for debt collection.

The last administration, I think, started that effort, and this one has continued to deal with the problem seriously. One of the reasons why this first chart looks the way it does, between 1981 and 1982, when we laid off 700 employees, is because of the fact that we had pretty much taken care of the backlog of unworked accounts.

We have developed, both through labor and through improved systems, when a claim is paid now, in the case of a FISL loan or in the case of an NSDS, when we accept the loan, it is automatically keyed into a computer system which generates three billing notices to the address we have.

Of course, we are using IRS skip tracing service. In fact, we have been using them for several years. That gets us the bulk of our money without anyone getting on the telephone calling anybody.

In addition to that, obviously, differentiating about the value of the account, we go further in the process with Federal employees, skip tracing and attempting to find another source of information for those people whom we are unable to contact, or those for whom we do have a good address, making direct telephone contact, if that is at all possible, and then we are using the collection agencies as a back-up partner in the process.

Mr. PENNY. Recognizing that we have an increased number of defaulted loans each year.

Mr. HASTINGS. But not at the Federal level. That is an important point. The $3 billion we are discussing is not at the Federal level.

Mr. PENNY. When you take into account the guarantee, though, that can fall back on the Federal Government.

Mr. HASTINGS. That is correct.

Mr. PENNY. Then the collection is our responsibility.

Mr. HASTINGS. Yes; we have—in fact, the bulk of the money that is in the default, though, is either the direct responsibility of the schools, in the case of NDSL or guarantors in the case of the guaranteed loan program.

Mr. PENNY. I would appreciate some information on the total outstanding defaulted loans and then how that dollar amount is changing from year to year as a result of those collection efforts. I would like to see on paper that we are, in fact, whittling away at that backlog through these efforts.

Mr. HASTINGS. Let me be clear how you are defining backlog. If your question is on the stuff that we have direct collection responsibility for, my answer stands. If it is with respect to other people who have direct responsibility, then there are some differences.

Mr. PENNY. I would anticipate that in putting together the information, you could differentiate the data in that way.

Mr. HASTINGS. Yes.

Mr. PENNY. Finally, in this chart which shows the collection efforts of the Department, and private collectors, do you include the origination fee in the blue portion here?

Mr. HASTINGS. No, sir.

Mr. PENNY. You do not?

Mr. HASTINGS. No.

Mr. PENNY. There had been some testimony by GAO there was a dispute between the Department and the OMB about whether the origination fee was being used to beef up the Department's collection fees.

Mr. HASTINGS. I am glad you raised that question.

Mr. PENNY. I would like to go——

Mr. HASTINGS. I would like to correct the record on that matter. GAO, I think is right, I think they perhaps haven't read their mail recently, but this chart deals only with student loans. It is my understanding that the Director of OMB sent a letter to the Comptroller General a couple of weeks ago with respect to what the Department of Education targets were, because there were some discussions back and forth between the Secretary's Office and the Director's Office about the inclusion of exclusion of loan origination fees which was in excess of $100 million.

I think that the new figure is not the $250 or $60 million shortfall for the Department, that GAO discussed, but is something $49 million, and most of that $49 million I am told is simply because the target kept or the base kept moving during the year.

There has been a 5-percent growth in the base.

So far as student loans are concerned, we, in fact, did meet, the Department did meet, in fact it exceeded its FISL and NDSL targets on the school NDSL collections and the State guarantee agency collections, where we really have moral persuasion is our best tool, plus the regulatory provision NDSL that Dr. Elmendorf just discussed, which really started to bite in last year.

We did not do as well as we would like to have done. We have, however, for instance, in the guarantee-loan area, just reached agreement with the National Council of Higher Education loan programs to establish minimum due diligence standards which all guarantee State agencies will follow in the collection of this paper, and we have also reached agreement with them concerning the assignment of some of this paper to the Federal Government, probably not directly, for collection where agencies are unable to effectively collect it themselves.

Mr. PENNY. Thank you, Mr. Chairman. I have no further questions.

Mr. SIMON. Mr. Gunderson.

Mr. GUNDERSON. Thank you, Mr. Chairman, and I can't imagine anything in the whole area of student financial assistance more important than this whole area. I hope that the chairman will continue these hearings in September when we don't have quite the legislative press of business we do in the last day of a session, to try to get at what can be done legislatively to increase the collections and decrease the defaults.

I can tell you that there is nothing that threatens the student financial aid program more in this country than 12- to 15-percent

default rates. To try to defend that out there in the country to the people is impossible. I think you know that, and we know that.

What I would like to focus on is a couple of different prospectives. I know that in looking over your testimony, that you are going to submit a package, a legislative package, to expand and hopefully improve the collection process.

Is there anything above and beyond that legislatively that you think we can or should be doing, I mean drastic action, I mean anything to the point of even consideration of consignment or garnishing of wages to getting tougher on the schools administering the programs?

What do you perceive in the area we can do that could improve the collection and therefore guarantee the positive credibility of the program?

Mr. ELMENDORF. Let me try to approach that from two perspectives. I think because of the rapid growth in the amount of claims paid, particularly for us paying the State agencies, with that going to $450 million estimated for 1985, the best thing we could do is to put systems collection in place by developing an alternative delivery system, or one that we think has in it the necessary requirements or elements, in letting the money out the door that allows us to follow the money through the institution, and after the student leaves the institution, to their place of employment, so that the default problem is one that doesn't occur when the student decides they are not going to make their payment, but it occurs when they start filling in the information to borrow the money in the first place.

The better we can track the information through the whole process, that is a long process, it goes through many hands, institution, State agency, Departments, student, the bank, regional office, we have to have a common element.

That is where the credit management system and project for developing alternative delivery is the most crucial thing, I think, of any that we could develop to take a bit out of the prospect of increasing the amount of default in the student loans.

The other items, such as coming down hard on institutions or coming down hard on the banks, they seem to be piecemeal approaches. Yes, I do think efforts—or legislative efforts to do that in a way that would yield good results, should be investigated, but my major concern is to catch the dollar before it goes out the door, and then to follow it once it does, so we can get it back into the Treasury, if the students decide to go into default.

I think, as I mentioned before, I think one of the significant things that was done by Congress under the Debt Collection Act was the ability to allow us to report defaulted student borrowers to the credit bureaus.

A consumer, once they leave college, is going to be buying appliances, and automobiles, and cars, and they are going to need credit, and they can get that credit if they pay off their student loan.

We had not ability to refer that information to a credit bureau until 1982. I think that is probably going to have a very serious and dramatic effect on collections.

Mr. GUNDERSON. One of the problems I have seen with the whole repayment of student loans, and I have received confirmation from

many college students in my district, that we simply require repayment too soon.

We are talking about a 6-month grace period before repayment is required. I have, in my office today, an intern who is completing her summer internship, she has completed college, she is trying to get a job, trying to get a place to live, trying to get furniture, trying to get a car.

There is no way that she can do all of those things to establish her independence and at the same time, within that 6 months, be able to make these initial student loan payments. I think she is going to be lucky enough to get a job.

Most of these young people in the economy today aren't even able to get that job in 6 months.

Do you have any kind of figures that indicate what percent of the defaults are defaults that occur, say, within the first year of their rescheduled repayment?

Mr. HASTINGS. I am not sure we do at the Federal level. I am fairly certain we could probably get you some information on that.

Mr. ELMENDORF. Directly from the States. The other thing I might add to that, keep in mind the Government has paid the 7 percent for the student and special allowance to the lendor to float that capital for 4 years.

The amount that the student pays back is only 7 percent. That is a pretty good interest rate, and a low interest rate, and in those cases where students have borrowed $20,000, or $15,000, through their graduate years, that payment at 7 or 9 percent would not be an onerous one after 6 months.

Mr. GUNDERSON. What do you project the average repayment is for a student completing 4 years of college?

Mr. ELMENDORF. Average repayment?

Mr. GUNDERSON. Monthly.

Mr. HASTINGS. I don't know the answer.

Mr. ELMENDORF. We, I think, can do some comparative analysis among the States to see whether there is a difference between New York and Wisconsin. It does differ by States, just as collection does. Each State agency differs significantly among the States. We would have to do an analysis.

Mr. GUNDERSON. I am not saying that the student loan program isn't a good program and a good deal, but I am saying that I think the reality of the world is such that many of these young people have a desire to make those initial payments, but they don't have the ability to do so.

And I think we ought to see if there isn't some better systems in which we can allow the initial repayment of these loans to be created in an environment whereby we are going to have a much higher repayment schedule than we do at the present time.

We can follow up on that later.

Mr. Chairman, I thank you and yield back the balance of my time.

Mr. SIMON. Thank you.

Just a couple of additional questions.

Are you finding that the loan consolidation, even though it has not been a major thing, is it having any impact on defaults, or is

this simply a convenience we are offering for people who have been through school?

Mr. ELMENDORF. The loan consolidation meaning what?

Mr. SIMON. The Sallie Mae and——

Mr. ELMENDORF. There hasn't been that much activity in the program until recently. We find that the average loan being consolidated is a $12,000 loan, which is rather high, and we are finding that those people are the ones that are most likely to pay off their loans.

The default among those with an average of 12 and over in the loan consolidation program is very, very low, I think it is less than a half a percent. I don't think we have had enough experience in the program to make significant judgments about it, but we do know that it is beginning to be a popular thing for people to do, particularly those with a high loan balance.

Mr. SIMON. I am a little concerned about the consolidation program—that we are moving slowly here now and that, that we are offering a convenience that may not be a necessity for some people.

As I look at the Chicago Regional Office and the Regional Office at San Francisco, are the numbers of employees roughly the same, so that these figures in those charts really mean something?

Mr. HASTINGS. They are roughly the same, and more importantly, I was meeting with Mr. Thomas last night, they have been conducting a series of audits on our collection efforts in the three regional offices, and I just got the figures, looking at them on a per-employee basis, which I think really gets to the heart of your question.

Our collections in San Francisco are $47,700 per month per collector, and that compares to $32,400 in Atlanta and $25,500 in Chicago.

Mr. SIMON. I don't know how areas are assigned. California is obviously a wealthier State than is, say, Mississippi. Have you taken these things into consideration? Whoever is assigned Puerto Rico, obviously, has a much tougher time.

Mr. HASTINGS. It is very difficult to do that, and I am not really sure that it is relevant for this reason: The initial assignment of loans bears pretty close relationship to the location of the regional office, in the proximity of the States.

But they are all running national collection agencies essentially because the borrowers are all over the country, and that is why I am not certain that it really makes any difference.

Mr. SIMON. OK. Then, one final question.

I have just talked to these employees, and I know how their lives are devastated by your saying, "Well, you are going to be out of a job, since we are shipping this off to San Francisco."

Does it make sense, instead of shipping all those files and offering some personnel jobs in San Francisco, that maybe we just need to change managers.

Mr. HASTINGS. Well, as a matter of fact, that is one of the problems we have, and that is one of the things that has led us to the idea that consolidation is the only thing that makes sense. Because with the reduced number of staff that we will have available in fiscal year 1984, we will be eaten alive by supervisory staff costs,

and we need to look at a more efficient way of doing the job with the smaller work force available.

And you mentioned earlier, in your questions to GAO, the question of—or maybe they raised it—the question of system improvements. It is an area we have been working on for several months. We have now developed software which is about ready to go on line in the next month or so, so instead of having this intensively paperbound operation that we currently have and have had for years, and which is kind of traditional in the business, when a debtor calls, the person who is talking to him simply punches in the social security number and accesses the data base on a CRT.

It is much more efficient, allows them obviously to handle more phone calls in a short period of time. We are putting in new phone equipment both to handle the distribution of calls more efficiently as well as to give us management data as to who is going what and who are our best employees.

Mr. SIMON. But do you think ought to make the move before you find those things out?

Mr. HASTINGS. We know what our work force is going to be in 1984, so we have got to look at that. And the other important point in this, one which we shouldn't lose sight of, the current term authority does expire in April 1985, and we have 303 term employees as of August 2 out of our total collection staff of 409, I think it is, 408 nationwide. That is three-fourths of our work force are employed as term employees.

We have the plan for the future in any case, and the future is almost upon us, when you are looking at April 1985.

So, all things together, that seems to make the most sense to us.

Mr. SIMON. We thank you.

STATEMENT OF JAMES THOMAS, INSPECTOR GENERAL, DEPARTMENT OF EDUCATION, ACCOMPANIED BY JOHN YAZURLO, DEPUTY INSPECTOR GENERAL; AND ANN CLOUGH, OFFICE OF AUDIT

Mr. THOMAS. Thank you, Mr. Chairman. Before I start, Mr. Chairman, may I introduce my associates out here. On my right is John Yazurlo, Deputy Inspector General. On my left is Ann Clough, with our Office of Audit.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today to provide an overview of Office of Inspector General activity in the area of student loan defaults and collections. I would like to present a brief summary of my written statement.

Our audit activities in the last year or so have included coverage of a number of areas related to student loan defaults and collections. A number of reports were issued and many broader efforts are still underway or planned. Our initiatives deal with activities of the Departm nt, State guarantee agencies, lenders, and postsecondary educational institutions and include review of the making and servicing of loans and collection of defaulted loans.

COMPLETED AUDITS

We have completed audits of numerous postsecondary institutions, guarantee agencies, and lenders. On the basis of these audits, we cannot project all institutions and lenders, but we did find that some schools were not effectively using the commercial collection agencies they hired to collect NDSL defaults, not exercising due diligence on NDSL defaults and not appropriately determining eligibility.

Some GSL lenders were not converting loans to a repayment status in a timely manner. All these contribute to increased defaults and collection problems. We made recommendations for appropriate corrective action.

ONGOING AND PLANNED AUDITS

We have a number of efforts underway or planned which will focus on broader aspects of default and collection activities of the Department, State guarantee agencies, lenders, and private collectors.

We are reviewing the efficiency and effectiveness of the Department's collection efforts on defaulted FISL and NDSL loans at the three collection regions and at headquarters. We are also reviewing the Department's GSL reinsurance claims processing system to assure existence of adequate controls for proper and accurate payment of claims.

We plan to evaluate the adequacy of internal controls over default collections by private contractors. The review will look at the Department's internal controls over the transfer of accounts and controls for insuring that collections are remitted in accordance with the terms of the contract.

We are currently surveying due diligence in making and collecting NDSL loans by several schools in one region to determine whether or not a nationwide audit should be made.

We are auditing eight guarantee agencies and some participating lenders. Our work includes due diligence in making, servicing, and collecting loans and timely filing of default claims.

COMPUTER MATCH PROJECT

We have been involved in several projects related to default collections and possible future defaults. In August 1982, in cooperation with OSFA, we matched defaulted loan records from the GSL, NDSL and FISL programs against Federal personnel data files. The match identified 46,860 current and retired Federal personnel who were holding 50,393 defaulted loans valued at almost $68 million. The results were turned over to OSFA for followup and collection efforts are underway. As of June 1983, the Department had received over $2.6 million on NDSL and FISL defaulted loans.

In another computer match effort, discussions have been held with State loan guarantee officials and with organizations which perform loan processing for various States to assist them in developing a basic screening process for applications using two computer programs which identify invalid or unissued social security numbers. Increased assurance of the validity of loan recipients should

ultimately result in the prevention of certain defaults. We are continuing to assess the effectiveness of the screening process.

PROPOSED LEGISLATION

We have a statutory mandate to review existing and proposed legislation in terms of the impact on economy and efficiency of programs and operations and prevention and detection of fraud and abuse. During recent months, we have worked with other offices in the Department to develop legislative proposals that we believe would improve internal controls over the making and disbursing of loans and would result in improvements in the collection process.

In summary, our experience indicates that there is room for significant improvements in default prevention and loan collection. Although much can be done within the existing legislation and regulations, some improvements can only be made through changes in laws and regulations. Certain actions taken by Congress and the Department demonstrate that the necessary commitment for improvement is there.

We need to continue our efforts to increase the efficiency and economy of these programs, and to prevent occurrences of fraud, waste and abuse within them. We plan to continue to allocate considerable resources to help bring this about.

Mr. Chairman, this completes my statement. I would be happy to answer any questions that you might have.

[Prepared statement of James Thomas follows:]

PREPARED STATEMENT OF JAMES B. THOMAS, JR., INSPECTOR GENERAL, DEPARTMENT OF EDUCATION

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today to provide an overview of Office of Inspector General (OIG) activity in the area of student loan defaults and collections.

For the Guaranteed Student Loan (GSL) program, data provided by the Office of Student Financial Assistance (OSFA) as of September 30, 1982 showed that default claims paid totaled about $2.0 billion on cumulative matured loans of about $17.3 billion. This represented a default rate of about 11.5 percent. OSFA preliminary data as of June 30, 1982 for the National Direct Student Loan (NDSL) program showed that, excluding those loans which have been assigned to the Department of Education by the schools, defaults were about $671 million on matured loans of about $6.4 billion, a default rate of about 10.4 percent. If assignments were included, loans in default would increase to about $1.02 billion and result in a potential loss rate of about 15.9 percent. These default rates are significant and we believe that improvements can be made to reduce defaults and increase collections. These improvements require actions on the part of all the various organizations involved in the student financial aid program and in many different areas of these programs.

OIG audit activities in the last year or so have included coverage of a number of areas related to student loan defaults and collections. A number of reports were issued and many broader efforts are still underway or planned. Our initiatives deal with activities of the Department, State guarantee agencies, lenders, and postsecondary educational institutions.

These activities include review of the making and servicing of loans and collection of defaulted loans. We are particularly interested in such areas as compliance with existing laws and regulations; management practices; timeliness of collection action; the economy, efficiency, and effectiveness of collection efforts; due diligence in collection of loans; evaluation of laws and regulations affecting defaults and collections; and any conditions which may lead to decreased defaults or increased collections.

COMPLETED AUDITS

OIG has completed audits of numerous postsecondary institution, guarantee agencies, and lenders. I will touch only on those findings which relate to loan defaults and collections. On the basis of our post audits, we cannot project to all institutions and lenders but we did find that some schools were not effectively using the commercial collection agencies they hired to collect NDSL defaults, not exercising due diligence on NDSL defaults and not appropriately determining eligibility. Some GSL lenders were not converting loans to a repayment status in a timely manner. All these contribute to increased defaults and collection problems. These efforts are detailed below.

In order to determine the effectiveness of postsecondary institutions' use of commercial collection agencies to deal with NDSL default rates, we reviewed nine randomly selected educational institutions in one region. We found that the schools often failed to expeditiously refer defaulted loans to collection agencies, left defaulted loans at collection agencies for extended periods without receiving any payments, generally failed to reconcile their referred accounts with records of collection agencies, and did not systematically assess the collection agencies' effectiveness.

In our opinion, these conditions were brought about by (1) school personnel not having sufficient training and experience in matters dealing with loan collections and (2) a lack of procedures to be followed for employing collection agencies, referring accounts, and reviewing collection agency activities. In addition, few of the schools had written contracts with collection agencies which spelled out the specific actions required of the agencies.

As a result, we recommended that OSFA establish procedures to ensure that schools devise a systematic approach for engaging collection agencies, referring accounts to and recalling accounts from agencies, and continually evaluating agency performance, so that the amount of returns on defaulted loans assigned to commercial collection agencies can be maximized. OSFA generally agreed with our findings.

A review of student financial aid programs at one college disclosed, among other things, that the college did not exercise due diligence in the collection and litigation of NDSL loans in default. At the time of our review, 60 percent of the loans which should have been in repayment status were, in fact, in default. Although the program regulations require institutions to take very specific steps to recover defaulted loans, we found no evidence that the college had made any meaningful attempt to collect the loans. In fact, it was the position of the school not to initiate litigation against defaulters as required by regulations. It was only recently, around the time of the audit, that the college hired personnel to begin to rectify this situation. We recommended that the college establish necessary policies and procedures and assign appropriate individuals to ensure proper administration of student financial aid. Action being taken by the school should correct the situation.

Prior to making financial aid awards, schools are required to determine that students who do not have high school diplomas or General Education Development (GED) certificates have the ability to benefit from the education or training offered. Audits of five schools disclosed various weaknesses in the schools' determination of students' ability to benefit from the programs offered. While written policies at all five schools required that applicants take written entrance examinations, auditors found three schools at which students who failed the admissions tests had been admitted, and two schools where errors had been made in scoring the test. Furthermore, the auditors found that many admitted students who did not meet the requirements of the written admission policies subsequently dropped out or were terminated by the schools. We believe that these deficiencies may account for significant amounts of misspent aid which result in defaults. We plan to look further at the award of aid to ineligible students in future audits.

In audits completed over the past year and a half at six lenders participating in the GSL program, we noted a lack of timeliness in the conversion of loans. This condition resulted in increased program costs of about $480,000 to the Federal government through excessive interest and special allowance payments and probably contributed to increased defaults because of delayed due diligence in collecting on the loans.

Under the GSL program, the conversion of a student loan to repayment status is predicated upon the date on which the borrower leaves school. Borrowers are required to notify lenders when their enrollment status changes. Regulations also require that schools report such changes to the lenders. Timely conversion of loans to repayment status requires the active involvement of borrowers, schools, lenders, and guarantee agencies to monitor, verify and report changes in student enrollment

status. Additional audits this year will include examinations of systems used to determine student status.

ONGOING AND PLANNED AUDITS

OIG has a number of efforts underway or planned which will focus on broader aspects of student loan default and collection activities of the Department, state guarantee agencies, lenders, and private collectors.

We are presently reviewing the efficiency and effectiveness of the Department's collection efforts on defaulted Federally Insured Student Loans (FISL) and NDSL loans. The audit is being conducted at the Department's three collection regions and at Headquarters. The regions collected $44 million in fiscal year 1982 and at September 30, 1982 had an inventory of 304,000 defaulted FISL and NDSL loans valued at approximatedly $434 million. A final audit report has been issued for our work in Atlanta. We recommended a number of ways of increasing efficiency and effectiveness of collection efforts. A draft report has been issued for our San Francisco work and a draft report is being prepared for our Chicago work. We anticipate issuing a consolidated draft report in September.

We are also reviewing the Department's GSL reinsurance claims processing system to assure existence of adequate controls for proper and accurate payment of claims. In fiscal year 1982, reinsurance payments to guarantee agencies totaled $218 million.

We are also evaluating the Department's procedures under which guarantee agencies submit collections made on defaulted loans. The agencies now have 60 days to transmit these receipts. We are reviewing the timeliness of submission of receipts and the feasibility of possible alternatives which may result in more timely submission. Because of the large amount of these collections submitted—$35 million in fiscal year 1982—savings to the Government in interest could be significant.

We plan to evaluate the adequacy of internal controls over default collections by private contractors. The review will look at the Department's internal controls over the transfer of accounts to the contractors and controls for ensuring that collections are remitted in accordance with the terms of the contract.

We are currently surveying due diligence in making and collecting NDSL loans by several schools in one region as a basis for initiating a nationwide audit.

We are auditing activities of eight guarantee agencies and some of their participating lenders. Our work includes due diligence in making, servicing and collecting loans and the timely filing of default claims.

INVESTIGATION ACTIVITIES

Most OIG investigation efforts in the student financial aid area deal with persons fraudulently obtaining loan funds, rather than with defaults or collection efforts. However, OIG recently investigated two firms employed by educational institutions and a guaranteed student loan servicing agency to collect on delinquent loans from students.

As a result of these efforts, a guilty plea was accepted by a State court from a private attorney retained by one of the collection agencies. The attorney had taken some $97,000 from various clients, including $27,000 in collected student loan payments. The subject was sentenced to serve 14 months in prison after having been previously debarred from the practice of law.

During December 1982, a 33-count indictment was handed down by a Federal grand jury charging the three principal officers of a collection agency with embezzlement, mail fraud and conspiracy. Their firm serviced over $200,000 in student loan accounts for a group of colleges in their local area. During March 1983, two of the individuals pleaded guilty to charges of conspiracy and mail fraud. In early June one was sentenced to one-year imprisonment, three years' probation, and ordered to make restitution of $1,648. The second person was given three months' incarceration and three years' probation. The third individual received a pre-trial diversion, having played only a minor part in the scheme.

COMPUTER MATCH PROJECT

OIG has been involved in several projects related to default collections and possible future defaults. In August 1982, the OIG, in cooperation with OSFA, matched defaulted loan records from the GSL, NDSL and FISL programs against Federal personnel data files. The results of these matches were turned over to OSFA for follow-up and collection efforts.

The match of over 10 million personnel records and the Department's defaulted loan files identified 46,860 current and retired Federal personnel who were holding 50,393 defaulted loans valued at almost $68 million.

Considerable effort has been and is being expended by OSFA to resolve the outstanding debts of Federal employees and, as of June 1983, the Department had received over $2.6 million on the NDSL and FISL defaulted loans. During the period December 6, 1982 to January 24, 1983, letters were sent to the debtors at the best available home address notifying them of the defaulted loans. The debtors were instructed to contact the appropriate officials to initiate repayment arrangements and were allowed 60 days to respond.

Heads of major Federal agencies have been asked to designate a liaison to assist in followup on those who have failed to comply. Persons not responding to these followup efforts may be subject to the withholding of a maximum of 15 percent of their wages through administrative salary offset until the defaulted balances are paid in full. The Debt Collection Act also gives the Department of Education authority to report all loan defaulters to national credit bureaus. This action is expected to be initiated within the next few months.

Since the Department does not hold the loans in default on guarantee agencies' accounts, a listing of non-responsive GSL debtors will be provided to the guarantee agencies for followup action. The Department will request status reports on their collection efforts.

In another computer match effort, discussions have been held with state loan guarantee officials and with organizations which perform loan processing for various states. The OIG has taken steps to assist the state guarantee agencies in developing a basic screening process for applications. The screening process makes use of two Department of Health and Human Services computer programs which identify invalid or unissued Social Security Numbers. These programs are useful to the state guarantee agencies in identifying questionable applications which require additional verification prior to loan approval and disbursement. This increased assurance of the validity of loan recipients should ultimately result in the prevention of certain defaults. The programs have been made available to several agencies with which OIG is continuing to work to assess the effectiveness of the screening process.

PROPOSED LEGISLATION

The OIG has a statutory mandate to review existing and proposed legislation in terms of the impact on economy and efficiency of programs and operations and prevention and detection of fraud and abuse. During recent months, OIG has worked with other offices in the Department to develop proposed legislation that would improve the operations of student loan programs. OIG's audit and investigative experience with these programs has proven to be very useful in this process.

We believe that legislating these proposals would improve internal controls over the making and disbursing of loans and would result in improvements in the collection process. Some of the more significant of these front-end improvements include allowing institutions and lenders to require endorsers on NDSL and FISL loans (guarantee agencies under GSL are already permitted to require endorsers) and requiring that, under most circumstances, GSL checks be sent to the schools with students named as co-payees. These provisions would help to ensure that borrowers use the funds for the purposes intended and may also lessen the likelihood of default.

Other proposed provisions would improve and add to available loan collection tools and minimize time lost in the process which occurs when the holder of a note does little in the way of collection activity before transferring it to the Department. Specific legislative provisions would allow the Secretary to require that NDSL loans be assigned to the Department under certain conditions and to require guarantee agencies to report GSL defaulters to credit bureaus under certain conditions (a similar provision already exists under FISL).

In summary, our experience indicates that there is room for significant improvements in default prevention and loan collection. Although much can be done within the existing legislation and regulations, some improvements can only be made through changes in laws and regulations. Certain actions taken by Congress and the Department demonstrate that the necessary commitment for improvement is there. For example, the Debt Collection Act of 1982 increases the efficiency of our efforts to collect debts owed the United States. Also, since last year, the Department cut off new NDSL funds to institutions having default rates exceeding 25 percent and reduced new NDSL funds to institutions having default rates between 10 percent and 25 percent, thereby providing a significant incentive to the schools to collect on their loans.

We need to continue in the direction set by Congress and the Department to increase the efficiency and economy of these programs, and to prevent occurrences of fraud, waste and abuse within them. As noted, we plan to continue to allocate considerable OIG resources to help bring this about.

Mr. Chairman, this completes my statement. We appreciate your interest in this very important area. I would be happy to answer any questions that you might have.

Mr. SIMON. Thank you very much, and we appreciate your recommendation and the legislative copayee change. Without having heard from the colleges, I think it sounds to me like it makes an awful lot of sense.

On the top of page 4 of your statement, you talk about a college that simply didn't exercise any effort, really, as it is required to do, to move.

Mr. THOMAS. Yes, sir.

Mr. SIMON. How many colleges and universities do you think are in that situation.

Mr. THOMAS. We don't have a way of knowing an exact number, Mr. Chairman, because oftentimes what we do is pick colleges because of problems that we become aware of either throughout hotline or through review done by program people or on a random basis, and I would have no way at all of extrapolating this to the universe of colleges that deal with these programs.

Mr. SIMON. Just guessing, are we talking about 25 percent of the schools, or 10 percent, or 5 percent, or 1 percent?

Mr. THOMAS. I would have no basis for a guess, but just to offer one I would say it would be on the low end rather than the high end.

Mr. SIMON. Mr. Gunderson.

Mr. GUNDERSON. Thank you Mr. Chairman.

Just one followup in regards to the proposed legislation. Are you talking about the legislation that Dr. Elmendorf referred to in his testimony, or are you talking about other proposed legislation?

Mr. THOMAS. I think we are talking about the same testimony, Mr. Gunderson.

Mr. GUNDERSON. OK. I would hope that the two of you—I see Dr. Elmendorf is still in the room. We could get the specifics. I guess you are going to introduce—do you know when it is going to be introduced, in the fall?

Mr. THOMAS. I don't know.

Mr. GUNDERSON. I will wait until that time.

Thank you, Mr. Chairman.

Mr. SIMON. Mr. Penny.

Mr. PENNY. Mr. Chairman, I am curious to know if your office, Mr. Thomas, became involved in any kind of review of the sizable layoff of the term employees in the collection area?

Mr. THOMAS. No, we have not been involved in the review of that process.

Mr. PENNY. So you would not then be able to offer an opinion as to what effect that might be having on the collection capability of the agency?

Mr. THOMAS. No, Mr. Penny. The only thing I have available is the same documentation that you have there, which are the statistics developed by Dr. Elmendorf and his staff on actual results. That is all I have available.

Mr. PENNY. We thank you.

Mr. SIMON. We thank you very much for your testimony.

Mr. THOMAS. Thank you very much, sir.

Mr. SIMON. Our final witness is Mr. Richard Horn, chairman of the board, General American Credit.

We are pleased to have you here today, Mr. Horn.

STATEMENT OF RICHARD L. HORN, CHAIRMAN OF THE BOARD, PAYCO AMERICAN CORPORATION, ACCOMPANIED BY NAT COLUZZI, CONSULTANT

Mr. HORN. Thank you, Mr. Chairman.

Mr. Chairman, and members of the subcommittee, I want to thank you very much for this opportunity to appear here today, and hope our comments will be beneficial to the subcommittee as well as the Department of Education.

I will introduce the gentleman to the right, Mr. Nat Coluzzi, who is a consultant to PAYCO American Corp. By the way, Mr. Chairman, I am chairman of the PAYCO American Corp. and General American Credit is one of our companies.

Our testimony has been presented so my comments will be within the allotted time.

Mr. SIMON. We will enter your full statement in the record.

Mr. HORN. Yes, sir. We have been asked to address four items in your letter of invitation here. One is the number of loans placed with PAYCO American Corp. Two is a contingent charge expressed as a percentage, and the general overview of how we go about collecting money for the Department of Education, and our success thus far in the program.

I really meant to congratulate this committee for its foresight in making it possible for millions of young people in this country to get a chance to go to a higher education opportunity, and we are proud of our part in supporting the Department of Education, at least in recovering some Federal funds.

There is no such thing as an unpaid account. The people who pay their bills also pay for the people who can pay but don't pay. In our business we are only concerned with the folks who can pay their bills but won't pay.

Most of the people, prestigious group that appeared, GAO and the Inspector General, no one knows much about PAYCO American. Very briefly I want to mention who we are, where we come from. Not many people have visited a collection agency. One of our largest offices is in Schaumburg, Ill.

This is brief background. We have been in business 50 years. I have been with the company 36 years. Last year we collected $134 million for the private sector as well as the public sector. We have five offices throughout the United States.

We got our start in the student loan collecting business back about 1952. We worked for the Ohio State University Mothers Club. Back in those days there was no Federal funding to give people a chance to get a higher education. Right now we serve every major guarantee agency in the private sector. Those include the United Student Aid Fund, Pennsylvania Higher Education Assistance Authority, Electronic Data System in California, and

Higher Education Assistance Foundation. They are four major ones.

We work for several of the GSL programs in the various States in the United States, and numerous NDSL campus programs we serve in the process of collecting their NDSL loans. Our subsidiary, University Accounting Service, controls over half the students in the areas of enrolled status, grace period status, and payout status. Last year we returned over $31 million back to the campuses as a result of our program. Of course we have had two major educational contracts. One was a pilot contract.

Now, to address the specific areas of your interest. The number of loans turned over to PAYCO American by the Department of Education were 96,000 loans. They are all handled in our office in Oakland, Calif. They are the NDSL and FISL loans. We have collected 5,000, approximately 5,000 loans to date, and we have 11,000 loans in repayment status.

If you look at the efforts that go into the collection of NDSL accounts before we get it, you will wonder how we collect as much as we do. There are five good efforts that precede our efforts, and every NDSL school has a service where they do in-house or go out on the street in the private sector and service their NDSL loans. And if the student is in the repayment status, and he deviates from his repayment pattern, then the due diligence program comes into effect by the servicer that consists of letters and phone calls, even mailgrams go out, and then phone calls followup at an interval of 30, 60, 90, 120 days.

If there is no response to the due diligence efforts, then the school may refer the account to a primary collector in the private sector. That collector pursues the paper vigorously for 6 months or maybe a year, and if he is unable to collect it, it is referred back to the school again, and then referred the second time to a secondary collector who goes through the process again in 3 or 6 months or a year. If he can't collect, it is returned. Then it goes to the Department of Education and the Federal collectors to pursue the collection process. If they are not successful, then the paper has been referred to a company like PAYCO American.

In the FISL chain of events the route is somewhat shorter. But at least three very good efforts are put on FISL paper for collection before the private contractor gets the paper. And that is, the bank, the bank servicers, the Department of Education, and then the private contractor.

I would like to mention the paper profile of the past two borrower accounts when it comes to the private sector collector. This is basically the profile for both NDSL and FISL. Many of the accounts are beyond—few of the accounts are beyond the statute of limitation. We believe that about 60 percent of the accounts referred to us have bad addresses. The defaulter borrower is a member of a marginal labor force. He is just getting started in finding his career path.

If he was educated as an accountant or schoolteacher or lawyer, he can't find a job. Now he may take a job as a bartender, construction worker, cabdriver, whatever. He does want to pay his bills, if you give him a chance. This group is highly mobile. They

are not skipping around on purpose. It is just the nature of their youth, and their early life in the economic society.

Some accounts that were referred to us were as much as 10 years old. The average is around 3 to 5 years old. And in that course of time, the previous efforts I mentioned by the bank and servicers and Department of Education has been applied to the account.

The loan repayment in the mind of the young man or woman has low priority. They want to pay their bill and will in time, but it is much easier to repossess a car or furniture or a home, their home property, but it is not possible to repossess an education.

I want to address our rate structure which was mentioned here. And it is a fact that we in our contract proposed a rate on the Federal insured loans as 38 percent contingent upon collection, and 43 percent on the NDSL accounts. The rate alone I don't think is important. I think the consideration should be net back. Simply it is this: How many dollars do I get back in relation to the dollars I place for collection?

If our rate is more, naturally we can spend more money to collect more money, and more net back equates to cost effectiveness. How many dollars you get back in relation to what you place?

It took us approximately 13 months before our income-to-expense line crossed. That is a major investment in our company and a lot of companies. It is not uncommon in the private sector for a collecting company to charge 50 percent, and sometimes more, if they are the second or third place in the collection process. Mainly the psychological impact has been exhausted in the previous contacts and time works to the benefit of the debtor.

The general overview of procedures used to collect defaulted loans, I want to detail in our presentation with flow charts how a complaint is handled. But the main thing in the collecting of this type of account is persistence and patience. We must abide by the Federal Collection Practices Act. That act does not hobble collection in any way. We live in human dignity. We know people want to pay if you give them a chance.

The collection cycles are to get payment in full that gets money back to the Government faster and they don't run the risk of losing contact with the default borrower.

Well, this is the flow chart of the collection itself in the testimony. Most of the people don't have the means to pay in full, therefore, we negotiate a repayment arrangement which we call a partial payment arrangement. That cycle used to be 18 months to allow a student to pay out his bill. Due to the economic factors now, to be realistic the partial payment arrangement time payout amounts to about 24 months to get a payment in full.

Our rate of success, well, is beginning a new venture entered into by a large Federal agency and company in the private sector. We have a common goal to serve the American taxpayer in a professional and cost-effective manner. We are proud of our efforts, particularly in the NDSL program, of returning many thousands and hundreds of thousands of dollars which are recycled back now so students entering college in the fall and subsequent periods will have a place to borrow money and the same opportunity their predecessors have.

Both educators and the private sector have learned quite a bit about this program. And what we have done I think is for education to be a model for the other agencies of government. This committee and the Department of Education truly have been a bellwether for the other agencies of government, and they are sure to follow in time.

Thank you, gentlemen, for your time. I will be glad to answer any questions you may have.

[Prepared statement of Richard Horn follows:]

PREPARED STATEMENT OF RICHARD L. HORN, CHAIRMAN OF THE BOARD, PAYCO AMERICAN CORPORATION

Mr. Chairman and members of the committee, I am pleased to appear before you today to discuss Student Loan Collections and government Debt Collection Project. The government and especially the Department of Education have made substantial progress in the development of better tools to manage receivables. However, much more is required, and we would like to provide guidance and assistance whenever possible.

Accompanying me this morning is Mr. Nat Coluzzi, a consultant to Payco American.

First, Mr. Chairman, I would like to congratulate you and this committee for its leadership in providing specific legislation for the use of private collection firms in the recovery of taxpayers' funds in the student loan program. The Department of Education now understands its responsibility for both, the making of loans and the collection of the loans.

There is no such thing as an unpaid account. The people who pay their bills also pay for those who do not. Of course, there are circumstances when some people cannot pay their bills, and that is why we have loan guarantee programs to spread the risks. However, we are concerned with people who can pay but won't, and thereby place a burden on the taxpayer.

Here are background data you may wish to know. Payco American Corporation marks its 50th Anniversary this year with pride in its caliber of service which has made it a reliable part of financial planning for its clients.

Since 1970 I have worked with several Congressional Committees: the U.S. General Accounting Office, the Office of Management and Budget, and a number of federal agencies in an attempt to provide information and understanding to the government, so that people in government will understand the need to seek professional assistance in debt collections, just as private industry has been doing for years.

Payco American has 53 offices in 41 major areas. These reach from New York to San Francisco and from Minneapolis to Miami. We number more than 1500 employees. In 1982 we recovered $134,000,000 from all sources.

One of our major divisions, University Account System (UAS) now services over one-half million National Direct Student Loans for 170 colleges and universities, and last year collected over $31,000,000 through this billing system. We would like to provide full collection and billing services to these institutions, but cannot since Section 674.49 of the NDSL Regulations prohibits institutions from contracting for both services to the same firm.

No other federal or state programs have such a rule. In fact, none of the other student loan programs have this limitation. Our modern computer system provides on line services to clients, and a series of reports that never leave a client in doubt as to the status of accounts.

In the student loan area, we also provide collection services for a number of nonprofit agencies servicing loans such as the Higher Education Assistance Foundation, and United Student Aid Funds.

PAYCO AMERICAN BACKGROUND IN STUDENT LOAN COLLECTIONS

Our first experience goes back to 1952 when we represented the Ohio State University Mothers Club. In those days there was no funding by the federal government to support people who wished to pursue post-secondary education. The source of funds for the Mothers Club were bake sales, bingo parties, etc.

In addition, Payco American represents all of the guaranteed loan programs in the private sector. We're very proud of our record with the United Student Aid Funds, Higher Education Assistance Foundation, the Electronic Data Systems Program with the State of California and the Pennsylvania Higher Education Assist-

ance Authority. In the guaranteed student loans program throughout the country we represent Ohio, Georgia, Florida, etc.

We're proud of our service record in serving the campus based National Direct Student Loan Program. Among our clients we serve Ohio State University, the University of Wisconsin, Harvard, Central States College, MIT, Yale, etc.

The Management Services Division of Payco American has produced audio/visual training program on collections and productivity for the Social Security Administration and the Farmers Home Administration.

We have been awarded two Department of Education contracts. Of all the federal agencies who have past due accounts requiring collection assistance from the private sector the Department of Education has been the bellwether. A full study of facts would clearly indicate the Education's experience with the private sector has been successful and cost effective.

Some facts concerning the current Department of Education student loan collections contract are as follows: Payco American has received $164,900,000 of $454,800,000 assigned to private contractors. Rate charged ED is 43 percent of NDSL Collections, and 38 percent Federal Student Loan Defaults. Since February of 1983, the Payco American San Francisco "Net Back" to ED is higher than the Atlanta and Chicago contract, which are at a lower rate.

Mr. Chairman, in your letter of July 27, 1983, you have requested an overview of the procedures used by Payco American. Let me first state that in this day and age, there should be no question as to whether the services of a private collection firm should be utilized, but only what stage of the collection cycle should these services be purchased. The private sector understands this, and usually seek out professional assistance on accounts 60 to 90 days past due, and almost always prior to the sixth month of delinquency. The government should follow the example of the private sector, and they would find collections up and cost down. In other words, the private sector will seek the assistance of the professional firm, long before government agencies. Yet government agencies attempt to compare rate of return and cost when things are not equal.

The NDSL loans turned over to us have been worked by the educational institution, one, two or more collection firms, and the Department of Education, Our experience reveals that 60 percent of the accounts turned over had bad addresses. Many of these loans have long since passed the statute of limitation. The FISL loans were worked by the original lender, ED's collection staff, and in some cases a private collection firm under one of the two pilot contracts.

Attached as Attachment A is a general overview of the procedures used to collect guaranteed student loans. Also, attached for your information is a "Federally Insured Student Loan Collection Sequence Flow Chart", prepared by Payco American, and a flow chart of procedures to be used when a complaint of alleged harassment is received.

It has been our experience that the longer accounts are not serviced, the higher the cost to collect, and the fewer dollars returned the Treasury. The most frequently asked question is, "What is your rate?" If you know collections, you should know that the cost of service is more in your control than the contractor. Three major factors in determination of rate are: (1) Condition of accounts to be turned over; (2) Amount of effort required; and (3) Documentation required on returned accounts.

You cannot expect the same rate for annual leave overpayments to former government employees as you would get for loans to medical doctors. Yet, federal agency people and congressional staffers have compared these rates and demanded an explanation of these differences.

SOME FACTORS IN RATE OF DETERMINATION BY THE CONTRACTOR

Here are some of the major factors used in determination of the rate to be charged.

I. Condition of accounts: (1) Total dollar amount of the portfolio; (2) Number of accounts; (3) Type of accounts, i.e. hospital bills, education loans, bank credit cards, etc.; (4) Average length of delinquency; and (5) Location of accounts.

II. Efforts to recover: (1) Letter series only; (2) Phone calls; (3) Skip tracing; (4) Length of time to make contact; and (5) Length of time to recover full debt.

III. Documentation: (1) File to be used, hard copy or computer format; (2) Collection effort on hard copy or computer format; (3) Reports system. Can the current vendor reports be used or will a new set of reports be required?

POSSIBLE RATES TO BE CHARGED GOVERNMENT PROGRAM

Again let me reiterate what federal programs can expect to pay contractors for collection service. For commercial loans averaging perhaps $10,000, on accounts delinquent less than two years, and a portfolio size of at least 500 loans, you may get a rate of 10–18 percent.

However, if the average account balance is less than $100, not secured by a note, and delinquent over three years, you can expect a rate of 45–50 percent, or higher, when considering other factors included in the RFP.

We recently reviewed one government portfolio that was so bad we advised the agency that we would not accept these accounts without a non-contingent payment of $9.00. This non-contingent payment was to provide certain documentation needed by the agency, before the accounts could be written off, in conformance with the joint standards regulations promulgated under the Claims and Collections Act. Of course, many other factors go into the rate determination.

However, if the government agency provides a good work statement, and program background information in their Request for Proposal (RFP), the competition will set a fair market price for services requested. We should not compare government internal cost of collections with the use of the private contractors unless the contractor is given similar accounts. Some past attempts to compare cost used government current account collections cost versus seriously delinquent accounts assigned to a contractor. If the competitive market is used, the rate will be fair.

Federal debt collection people should be out visiting private collection firms, now in order to get a better understanding of current business practices. For example, for questions asked of us, we get the impression that some government program people, and congressional staffers, do not fully understand the terms "Net Back", "Profit", or "Bottom Line". To let a collection contract on the basis of lowest rate may make life comfortable for the program persons, when attempting to justify selection of higher rate to Inspector Generals, Auditors, Office of General Council, or Congressional Staffers. (Please note that I did not mention the U.S. General Accounting Office, or the Office of Management and Budget since these two agencies seem to understand the selection process for collection services.)

In effect we are saying, how much money is returned. For example, if the rate charge is 10 percent and the contractor collects $100,000, the net back is $90,000. However, if the rate is 30 percent and the contractor collects $300,000, the net back is $210,000 the private sector usually prefers spending $90,000 to collect $300,000 rather than $10,000 to collect $100,000. We feel that the government must also understand the Bottom Line, or Net Back.

HOW TO INCREASE COLLECTIONS

In the collection business, the old adage still prevails, "You have to spend money to make money". Since private contractors usually work on a contingency basis, they must be prepared to spend money for several months before the break even point is met. In the Department of Education contracts, at an average rate of 40 percent, we were over one year into the contract before we began to see some profit. We at Payco American live by the four P's: Paper, People, Phones and Profit.

As to the Payco American success rate thus far in collecting student loans, we have collected and turned over to the Department of Education approximately $15,000,000 through May. Of this amount $5,300,000 was collected under the pilot contract, and $9,700,000 has been collected under the current contract.

We are proud of this record when you consider that the NDSL paper was 4 to 6 years in default, and had at least four thorough collection efforts prior to placement with Payco American. 60 percent of all loans received were addresses unknown for extended periods of time.

The FISL loans turned over for collection had at least two or three major collection efforts prior to our collection efforts. Most of this paper would have been written off as uncollectible by other government agencies.

Since government agencies can be put into a Catch 22 situation with contractor collections (the more money collected the higher dollar cost) through the normal budget system, we would recommend Senator Percy's Bill S–349, which provides for payment of contractor fees out of collections. Cost are directly related to benefits. Using net back an agency would not be put into the embarrassing situation of stopping a successful program for lack of funds.

CONCLUSION

Mr. Chairman, I am convinced that improved Debt Collection would provide better Cash Management, and integrity to the front end of programs. We will be pleased to answer any questions you and the Committee may have.

ATTACHMENT A

GENERAL OVERVIEW OF PROCEDURES USED TO COLLECT GUARANTEED STUDENT LOANS

First, all collectors are thoroughly trained on the FDCPA and must pass written and oral examinations before any attempt is made to contact a defaulted borrower. General procedures go like this;

The paper work is done; the acknowledgment; the set up of the control file, etc. All payments to the account are made electronically, therefore, audit trails are clear.

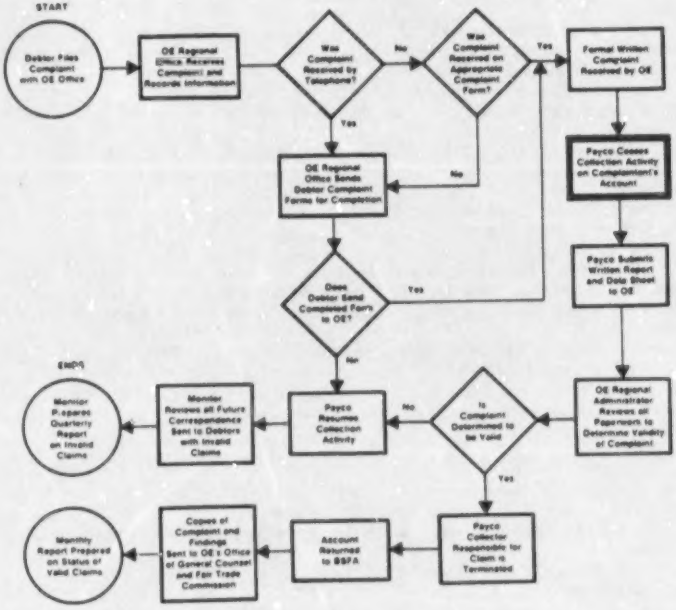
1. The collector reviews our backup documentation supplied by the guarantor.
2. Collector studies previous application of effort performed by the lender and the guarantor.
3. Collector develops the account, verifies the address. Is debtor a property owner? Checks phone directory for assistance. Does address check with phone number?
4. If mail is not returned assumption is made that address is okay. References are checked. Credit reports are obtained. Information obtained from school which was attended. Once these preliminary steps are taken the borrower is contacted. This is the borrower's first dealing with a collection agency, and the borrower is very much on guard.
5. Our objective is to attempt to get payment in full, or determine what indebtedness he might have to determine if he might be eligible to borrow money. If he cannot borrow the funds from a bank, credit union or relatives he is requested to provide the collector with two loan denials. If we know the borrower is employed we proceed to encourage him to borrow the funds.
6. If the borrower is temporarily unemployed, or has part time work, payment arrangements are negotiated.
7. All payment arrangements are temporary and are reviewed in 6 and 12 month periods. When a payment plan is agreed upon there is diligent follow up. Debtor is contacted if there are no payments, or the payments are in an amount less than agreed upon.
8. The guarantors in the private sector make the sole decision whether or not an account should be litigated. This is after the collector exhausts all amicable efforts.
9. Collection time frame for the first phase is between 30 and 90 days. Collection possibilities are ascertained.
10. If payment in full is not obtained the repayment program takes about 24 months. This requires very prompt follow up. This time period used to be 18 months. but has been extended because of economic conditions, greater unemployment and tighter credit.

One of the reasons why the recoveries are higher in the private sector is the time frame from default to collection agency referral. This period on the average is 4 months.

Very briefly here are the steps: Borrower defaults in repayment program to bank. Bank follows through on due diligence steps. Bank requests Lender Request for Assistance form from the guarantor. The lender goes through aversion steps. If borrower responds promptly the account goes back to billing status. If the borrower does not respond, his account is referred to collection immediately.

payco

Complaints of Harassment Flow Chart


START
Debtor Files Complaint with OE Office
OE Regional Office Receives Complaint and Records Information
Was Complaint Received by Telephone?
No
Was Complaint Received on Appropriate Complaint Form?
Yes
Formal Written Complaint Received by OE
Yes
OE Regional Office Sends Debtor Complaint Forms for Completion
No
Payco Ceases Collection Activity on Complainant's Account
Payco Submits Written Report and Data Sheet to OE
Does Debtor Send Completed Form to OE?
Yes
No
END
Monitor Prepares Quarterly Report on Invalid Claims
Monitor Reviews all Future Correspondence Sent to Debtors with Invalid Claims
Payco Resumes Collection Activity
No
Is Complaint Determined to be Valid
OE Regional Administrator Reviews all Paperwork to Determine Validity of Complaint
Yes
Monthly Report Prepared on Status of Valid Claims
Copies of Complaint and Findings Sent to OE's Office of General Counsel and Fair Trade Commission
Account Returned to BSFA
Payco Collector Responsible for Claim is Terminated

A complaint will be considered *invalid* if the research uncovers no false/misleading operations, or that the allegations by the debtor are determined to be untrue.

1. Payco will resume collection activity on the account in question.
2. The on-site Monitor will be required to monitor all correspondence sent to the debtor concerning the debt.
3. OE Research Section, with the help of the on-site Monitor, prepares for the ARA/CC a quarterly report on the collection activity related to invalid complaint accounts. The report provides a collection history on this account until the debtor begins repayment or until the account is returned to BSFA.

If a complaint is classified as *valid*, the following actions will occur:

1. The Project Officer notifies the OE contracting officer of the problem.

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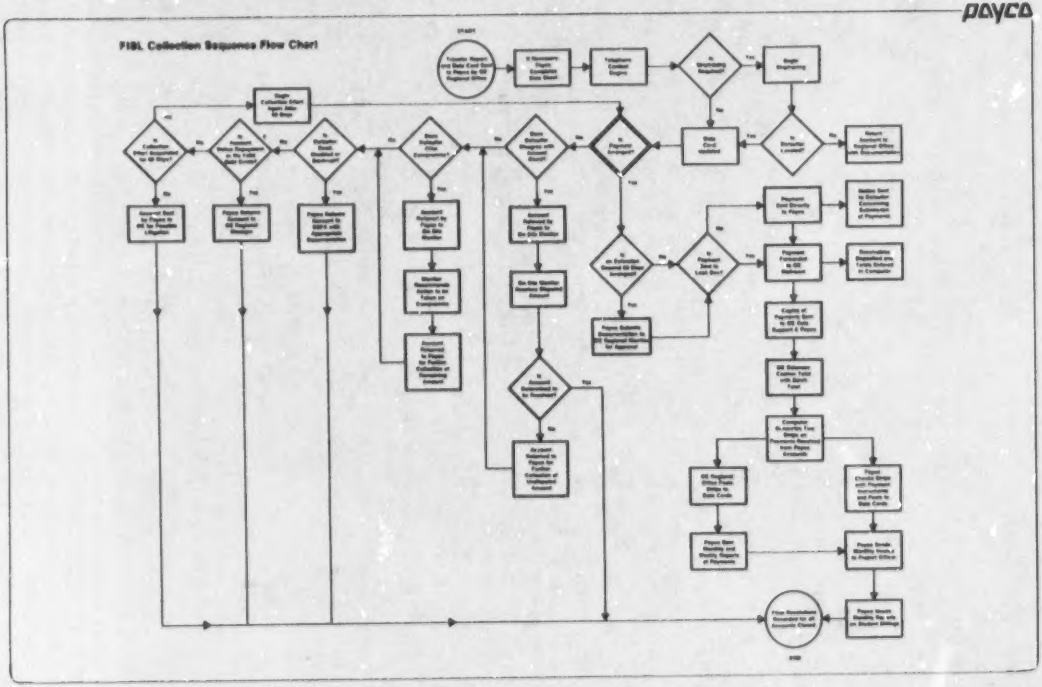

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Mr. SIMON. Thank you very much for your testimony. If I may, you heard the earlier testimony that mentioned it is on a competitive bid basis. I am curious why we end up with 43 and 38 cents for PAYCO and 24½ cents for the other company. Why this huge disparity?

Mr. HORN. Well, before we enter into any contract many factors are considered. On this issue, region IX of education, I understand that did the best job of the 10 regions in recovering money. That means the paper coming to us is a little more difficult.

Two, our experience, going back at least two decades, knows the cost to collect a student loan account. High mobility and all the activities that occur before we get the paper. Even in the private sector, the average rate is approximately 35 percent, between a third and 45 percent. In the private sector, the first law of business is not to lose money. We had to make a major commitment over 13 months of investment before we rounded the corner. Our experience in other student loans, NDSL and other guaranteed loans, gave our management a basis for an intelligent decision—what does it cost to collect the paper and to do a good job.

Again our focus is on net back. Someone could offer us 9 percent, and I am sure that you would be disgusted with the results.

Mr. SIMON. If I am reading between the lines, you think that someone just underbid on the other contract?

Mr. HORN. I have no idea how they compute their rates. I don't know what they do.

Mr. COLUZZI. Let me help. It is probably one of the mistakes most often made by people for the first time frequently in government, since there are very few people at the upper echelons of government that have had experience with a private collection agency. When was the last time you hired on your staff a debt collector. The training is almost on site with the company. There are now approximately eight large major firms, several thousand small firms, but when you are in the ballpark competing on a bid, you are looking at things today as to what you perceive the portfolio to be, the recoverable rate.

We had at PAYCO formulas and we even have a computer that does analysis. You crank in the information you can get. As that information is massaged, it comes out with what you should bid. That is all with projections what the return rate is going to be. And each company may have a different way of looking at it, as to what their costs are and how much they anticipate to recover.

It is only with hindsight you can say whether it was profitable or not for the corporation; that is, the collection corporation is profitable. The person who gets the contract has to worry about whether or not the bottom line is best, the net back. So you have got all three factors going for you.

In the front of contract, the corporation spends money. You are asking what the comparison of recovery is between private sector and the government. You have to analyze in the private sector what their costs were, and that is very difficult to get because they are not going to tell you.

We are not going, PAYCO is not going to tell its competitors how much they spend for this and that, plus there are other things that are buried in there, cost of the new computerized system that we

have got. But the basic determination of the cost is really at the agency or the private sector corporation. If you get good, recoverable accounts, the cost go down. If you throw in real difficult accounts, the price goes up. And you can mutualize systems by throwing in the good and bad and come across the lines.

Mr. SIMON. Let me say, when we first authorized the private collections in 1978, there were real mixed feelings in our conference committee on this thing. I was one of those who went along reluctantly. I was afraid we were going to have a lot of complaints, a lot of people called at 3 in the morning and so forth. And I have to tell you I don't recall receiving a single complaint.

And I may say, my staff may want to correct me on that, if we have received any we have not received very many, and I say that is to your credit.

One final question and I will yield to my colleague. On one of the pages of your testimony you say one of our major divisions, University Account System, now services over one-half million national direct student loans for 170 colleges and universities, and last year collected over $31 million through this billing system. We would like to provide full collection and billing services to these institutions, but cannot since section 674.49 of the NDSL regulations prohibits institutions from contracting for both services, that is, collection and billing, to the same firm.

I assume we did that to protect the students, or that was the theoretical basis for our decision.

Mr. COLUZZI. Years ago when the national direct student loan program was starting to run into its severe problems of defaults, and in those days they didn't have definition of default even——

Mr. SIMON. This was deliberately put in when the NDSL program was initiated. This is not part of the 1978 amendment.

Mr. COLUZZI. It is not part of the amendment. It is regulatory by the Department of Education. What happened, they had one case, to my knowledge, there may have been a few others, where a certain institution, educational institution hired a collection agency to do a billing and collection operation and this particular organization that they hired caused accounts to deteriorate in billing and go into collection. The billing rate is much lower than collection rates, so the company was making more money. So logically it sounds like billing.

However, that was a small company that obviously didn't know what it was doing, because in our case billing is, you clip coupons for your money. Once you enter the system in, there is no manpower, it is all computerized operation. What later happened is, at the time they put it into the regs in the Department of Education, it was prior to their use of due diligence requirements on the part of the institution. They were supposed to remove that one, at least according to the individual who put it in the regulations tells me now, remove that provision when he got due diligence requirement. Not regs, they put due diligence.

Now you have the situation where a company like PAYCO that does both billing and has cure procedures and, where you can have a continuity of operations, it is prohibited by this regulation from its continuity. They must drop it out of the bill and send it back to the institution, then back to somebody else for the collection oper-

ation. Very, very difficult. And the worst part is that the Department of Education has caused an industry to change its way of doing business, and now that industry doesn't want to come back to comply with it, to remove the regulation. They would be opposed. There would be a lot of opposition to removing the regulation because the industry designed it to fit the rules designed by the Government agency. A horrible example.

Mr. SIMON. Mr. Penny.

Mr. PENNY. Now that I know what I have to go and vote on, I have a couple of questions I want to ask before I leave.

How many years are you contracted to collect on these loans for the Department?

Mr. HORN. A 3-year contract.

Mr. PENNY. It runs out when?

Mr. HORN. 1985.

Mr. PENNY. Are you given new paper each year?

Mr. HORN. We hope so. The last paper we had was in October, and the recoveries would be significantly higher if we had the paperwork in the system.

Mr. PENNY. Did you expect when you signed the contract that new paper would be turned over to you each year to increase the total amount of loans?

Mr. HORN. Yes, sir.

Mr. PENNY. And that has happened but you haven't received any recently?

Mr. HORN. No, not since October.

Mr. PENNY. When you contracted, did you contract for a percentage of the collection to increase each year of that 3-year contract?

Mr. Simon asked about 38 and 43 percent take for PAYCO. That is apparently what is being paid now. But did you contract for that percentage rate to increase in the second and third year of the contract?

Mr. HORN. I believe it is negotiable. The main reason is that we are labor intensive; 60 percent of every dollar of income goes to collection. Labor costs rise every year.

Mr. PENNY. That part could be negotiated?

Mr. HORN. Yes, sir.

Mr. PENNY. Up or down. If you get new paper, it seems to me that there might be some reason to negotiate that downward, because any paper that might be turned over, in my view, would be newer in terms of the default.

Mr. HORN. Yes, sir, better paper, with addresses.

Mr. PENNY. If you don't get new paper you might be trying to negotiate for a higher percentage.

Mr. COLUZZI. We won't get a higher percentage. Education would probably try to negotiate downward if they would give us better paper.

Mr. PENNY. You would expect the Department will try to negotiate downward if they turn over additional paper?

Mr. COLUZZI. If they are smart.

Mr. PENNY. I heard the contract included a higher rate in the second and third year, and I was curious as to why that would be the case if in fact you were going to get new paper.

Mr. COLUZZI. I think there was an earlier contract which had an escalating clause. You can negotiate all kind of contracts. The first contracts, the pilot contracts, provided for a different rate to the agency of the paper coming out. That was the pilot contract which Payco had a contract. The newer contracts are fixed rates for the 3-year period of time, fixed relative to 3 years of the contract. There is a period of time beyond the 3 years actual, it is three, there are two options. First year then two options. But the contract goes beyond that as they collect down some more money. The rate don't go up.

Mr. PENNY. What provision is there for 1986-87, those areas, after the contract expires? Are you operating on the assumption this is going to be renewed, or is there a risk that we just cancel the whole arrangement and the Department goes back——

Mr. HORN. We hope it would be. As an example, the pilot, the termination date was December 31, 1982. We had an impetus going on payment at a rate of $50,000 to $70,000 a month, and that date we closed down, and we didn't receive any benefit from the commissions on ongoing collections. So we hope that all things being equal and that both parties, we earn our keep, and we are cost effective and in your judgment the program will continue.

Mr. PENNY. Can you speculate what the rate you might charge if the Department of Education turned these loans over to you at about 6 months, the way most private firms would, just a ballpark figure?

Mr. HORN. Expressed as a percentage?

Mr. PENNY. This is kind of short notice for that kind of calculation. However, it would be I think significant and interesting.

Mr. HORN. We want the Federal collector to be in the picture. We propose in there for 120 days, 6 months, on a vigorous collection effort either to get payment in full or satisfy payment arrangements that fit the policy. Then, if there is no, don't conform to the two things, payment in full or partial payment arrangements, then it goes to the contract collector.

Mr. PENNY. You didn't give me a ballpark figure on percentage.

Mr. HORN. You are asking a definite percentage?

Mr. PENNY. I am not asking for a definite, I am asking for a ballpark.

Mr. COLUZZI. NDSL or GSL?

Mr. PENNY. The same kind of thing you are getting today, just getting them earlier.

Mr. HORN. Ballpark, probably 5 or 10 percent. That is from 38 to 32 possibly.

Mr. COLUZZI. Remember now we have put up a lot of front money that is already taken care of. You can perhaps go down, before that front money.

Mr. HORN. One last thing. Could you submit some information for the committee's record on how you have negotiated for repayments, what portion have been settled entirely, in their entirety, what portion have been rescheduled under what terms, and what loans you may have settled at a lower dollar amount than actually was owed? I am not asking you to give me figures now.

Mr. COLUZZI. We can't negotiate at the lower dollar.

Mr. SIMON. If I could take the liberty, we are going to have to rush over for a rollcall. I was also interested in the fact you said you have received no paper since October. Does that mean for 8 months there has been no new paper turned over to you for collection?

Mr. COLUZZI. Yes, sir.

Mr. SIMON. Sounds like something is massively wrong somewhere.

Mr. COLUZZI. They are I think into the period of time trying to determine whether or not they go more private, less in-house, et cetera, et cetera. Our position has always been you don't cut off all the internal operation, you have a cooperative operation.

Mr. SIMON. Prior to that, you were just on a monthly or weekly basis getting paper, or— —

Mr. COLUZZI. We would hope for, like most, the private-sector clients, a regular routine schedule. Most of our clients every month send paper over in the private sector. The Government ought to be somewhat the same.

Mr. SIMON. Absolutely. It usually results in the loss of revenue for the Federal Government.

Mr. COLUZZI. Yes, sir.

Mr. SIMON. I thank you very, very much, and we are going to followup on that last item. We thank you for your testimony.

Our hearing stands adjourned.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned, to reconvene, subject to the call of the Chair.]